

21 June 2016

Principal Advisor
Commercial, Consumers & Communications
Branch
Ministry of Business, Innovation & Employment
PO Box 1473
WELLINGTON

Email: societies@mbie.govt.nz

Attention: Geoff Connor

Dear Geoff

EXPOSURE DRAFT: INCORPORATED SOCIETIES BILL

1. The External Reporting Board is pleased to comment on the exposure draft (ED) and draft Incorporated Societies Bill (draft Bill). Our comments relate to matters in the ED and Bill on financial reporting and assurance.

“Financial gain”

2. Clause 21(1) of the draft Bill states that a society must not be carried on for the financial gain of its members. If a society has a financial-related gain purpose it is ineligible to register as an incorporated society (clause 8(1) of the draft Bill). Clause 22(1) defines “financial gain” and clause 22(3) clarifies circumstances that do not meet the definition of a society having a purpose of financial gain.
3. We consider it may be difficult for some societies to operationalise clause 22(1)(a). Clause 22(1)(a) states that a society is treated as having a purpose of financial gain if “it distributes, or may distribute, any gain, profit, dividend, or other financial benefit to any of its members (whether in money or in kind)” [emphasis added].
4. Clause 22(3) allows a society to engage in trade. We understand many incorporated societies generate a large proportion of their revenue from selling goods and services. It is not clear if the profits from such trading transactions that are used by a society to provide subsidised goods and services to its members could be considered to be distributions “in kind” in accordance with clause 22(1)(a).
5. We recommend that the proposed Act clarifies the meaning of “distributions in kind” in this context.

“Fair value”

6. Clause 60(2) of the draft Bill states that a society cannot avoid a transaction if it receives “fair value” under it. Clause 61 sets out the definition of “fair value”.
7. Under the proposals, if a transaction is entered into by the society “in the ordinary course of its operations and on usual terms and conditions”, the society is presumed to receive fair value under the transaction.
8. The term “fair value” is used in accounting standards, legislation (for example, the Companies Act 1993) and in case law, each with different meanings and interpretations. We note that “fair value” as proposed in the draft Bill, has a different meaning (and a different way of establishing value) to that used in accounting standards. We think this may give rise to potential confusion, particularly when societies apply accounting standards.

Financial reporting proposals

9. Clause 83 and clause 84 set out the proposals for financial reporting by societies.
10. We note that clause 83 is inconsistent with recent law changes in respect of entities that are separate legal entities. Clause 83(1) proposes that the “committee of a society” must ensure that, within 6 months after the end of the accounting period, financial statements are prepared and registered.
11. Under recent changes to the Companies Act 1993 and the Financial Markets Conduct Act 2013, certain legal financial reporting and assurance responsibilities are placed primarily on the entity as a separate legal entity (rather than on those charged with governing the entity, for example, directors).
12. We recommend the proposal for financial statement preparation and registration line up with the recent legislative changes in the Companies Act 1993 and the Financial Markets Conduct Act 2013 given that a society is also a separate legal entity.

Assurance

13. Paragraph 106 of the ED states that the draft Bill does not include assurance requirements for societies but the Ministry proposes to make recommendations to the Government on assurance-related matters following the consultation.
14. We agree with the reasoning for assurance requirements for societies that are registered charities: they apply the assurance requirements under the Charities Act 2009¹. We also agree, in general, with the rationale for

¹ We note that para 107 of the ED incorrectly refers to annual revenue of \$500,000 as the size criterion in section 42D of the Charities Act 2005 for independent assurance requirements. Section 42D of the Charities Act refers to operating expenditure (not annual revenue) of \$500,000.

assurance requirements for societies that are not registered charities: they should be treated the same for assurance purposes as other entities that are not publicly accountable under the law.

15. However, we do not agree that the measures in section 45 of the Financial Reporting Act 2013 (total assets of \$60 million or annual revenue of \$30 million for each of the two preceding accounting periods) are appropriate for societies for determining their assurance requirements.
16. Similar to registered charities (and given the non-profit nature of societies), we consider that operating expenditure is the appropriate measure to use (rather than revenue or total assets) to determine when a society should be subject to assurance. The use of revenue and assets means that different measures will be used for assurance purposes depending on whether a society is a registered charity or not.
17. Using revenue and assets also means that different measures will be used for assurance and for financial reporting purposes. In the draft Bill, a society that is a "specified not-for-profit entity" must comply with GAAP and a society that is not a specified not-for-profit entity may comply with a non-GAAP standard. The measure used to determine a specified not-for-profit entity is operating expenditure (not revenue or asset).
18. We therefore recommend the use of operating expenditure instead of revenue or assets for determining the assurance requirements of a society that is not a registered charity.

Transitional provisions and incorporated groups of branches

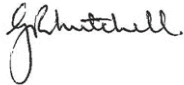
19. The draft Bill allows branches and groups of branches of a society that were registered under the Incorporated Societies Amendment Act 1920 to be incorporated under the proposed new Act as branches or groups of branches.
20. We consider these proposals may potentially create confusion when groups of branches apply accounting standards, in particular, when applying the concept of control for the purposes of preparing group financial statements.
21. We recommend that groups of branches of a society that were registered under the Incorporated Societies Amendment Act 1920 be required to assess their position to determine if it remains appropriate for them to be registered as a group.

Other miscellaneous matters

22. Clause 73 of the draft Bill states that a society must call an annual general meeting [emphasis added]. In the Companies Act 2013, it is the board of the company that must call an annual meeting of shareholders to be held [emphasis added]. We suggest that the responsibilities of the committee and the society, as a separate legal entity, for various responsibilities to be made clearer throughout the proposed Act and that these be made consistent with the Companies Act 2013.

23. We also suggest that it may be useful to clarify that the financial statements a society is required to file is in an official New Zealand language.
24. If you have any queries or require clarification of any matter in this submission, please contact Lay Wee Ng (laywee.ng@xrb.govt.nz) or me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'G. Mitchell'.

Graeme R Mitchell

Chairman
External Reporting Board