

Submission on Consultation Document – Proposed Improvements to the Tier 4 (NFP) Standard (“Document”)

The Document recognises a key point on page 6 that “small Tier 4 NFP entities often have limited resources available and find it difficult to attract and retain volunteers or staff who have experience completing annual reporting requirements in accordance with XRB standards”. I suggest that many NFPs will be in the same position, not just those which may be seen as “small”. Many may find it costly to employ professionals to prepare or audit such reports, even if they can find professionals who are willing to carry out such work for small scale organisations.

The simplification aim of the Document’s proposals is laudable but I am concerned that uncertainty and some difficulty will remain in applying the proposed revisions.

I think some confusion and uncertainty arises, and will remain, because of the multiplicity of sources that need to be referred to, including:

- Legislation under which an organisation is formed, such as the Incorporated Societies Act 1908 (or 2022 in due course), Companies Act 1993 and any related regulations.
- Other legislation which may apply to and regulate an entity in relation to its reporting requirements, such as the Charities Act 2005 and Financial Reporting Act 2013.
- A body’s own constitution or rules.
- External Reporting Standard (XRB) accounting rules.

In practice I suspect many of those unpaid volunteers who are tasked with preparing reports for small NFPs will just look to, and focus on, completing any template form available. If a “one stop shop” cannot be provided, it would therefore be useful and desirable to include some additional definitions or other information within the template, rather than assuming users will be able to, and will, seek out other sources of information.

My main concerns about the proposals relate to:

- (1) Disclosure of grants and proposed distinction between outright grants and “service delivery grants”.
- (2) Determination of “significant” resources/assets and commitments/liabilities.
- (3) Related party transactions.
- (4) Levels of “smallness”, their relevance and application.

(1) Disclosure of grants

It is proposed that grants made for delivery of specified goods or services should be disclosed separately from other grants of money.

Determining whether grants are for service delivery may be confusing for non-profit bodies that are GST-registered. The Document (pages 8 and 9) gives an example of a grant to provide a specified number of counselling service hours, which seems obvious enough, but the situation may not be clearcut in other cases, particularly where grants are received by GST-registered NFPs from the Crown or other central government agencies.

Non-profit bodies do not need to return GST output tax on unconditional gifts received, which covers grants made to them by many organisations. Grants made by the Crown or central government agencies (such as Te Papa), however, are excluded from being unconditional gifts for GST purposes, so GST-registered non-profit bodies must return GST output tax on such grants. The implication is that such grants are being made in consideration of supplies of goods or services, even

if the recipient is not actually supplying any physical goods or services to anyone else in exchange for the grant. NFPs may not see much substantive difference in practice between grants from central government and those from other funding agencies – both types may require applications to be for specific purposes and items of proposed expenditure and may require subsequent accountability for the application of any grants made.

The Glossary on p20 of *NZASB ED 2022-6 -Tier 4 (NFP) Standard Exposure Draft* (“ED 2022-6”) limits “service delivery grants/contracts” to those requiring the recipient to provide goods or services to the funder or to third party beneficiaries. It would therefore seem to exclude central government agency grants to GST-registered non-profit bodies which cover proposed expenditure within the recipient’s general activities rather than being for specific supplies to others. I suggest it would be helpful to clarify the treatment and to incorporate the glossary definition within the template and any examples, rather than force users to ferret through various links for clarification.

(2) Determination of “significant” assets and commitments

I accept the desirability of NFPs providing information about assets and commitments and of limiting it to more substantial or material items if no balance sheet is provided. But I am concerned that introducing the “significant” qualification will only cause uncertainty and difficulty and may not lead to better disclosure, consistency or comparability from year to year or between organisations.

I note the minimum requirements in section 104 of the new Incorporated Societies Act 2022 would require disclosure of all assets and liabilities as at balance date (among other things) if “small society” NFPs choose to apply that provision.

(3) Related party transactions

Particularly where there are no paid employees, many transactions are undertaken by volunteer members, committee members or other office holders on behalf of their NFPs. Examples commonly include:

- Cash collection, holding and banking.
- Purchases of goods or services paid for initially by the member, committee member or office holder and subsequently reimbursed from NFP funds at cost.
- Goods and services provided to NFPs by members, committee members and office holders, their family members and friends on an unpaid voluntary basis.
- All operations and administration of an entity carried out by such people on an unpaid voluntary basis.

Please clarify whether and if so, how, NFPs should disclose any of the above common transactions.

(4) Levels of “smallness”, their relevance and application

The Tier 4 standard is a non-GAAP standard which may be used by NFPs that are not large or “specified not-for-profit entities”. “Smallness” in this regard broadly means annual operating payments for each of the preceding two accounting periods were under \$140,000.

ED 2022-6 proposes another level of “smallness”, with further reduced reporting requirements. “Small” entities for Tier 4 purposes would be based on having total annual payments for the current and previous year of less than \$10,000. The proposed test involves subtle, but critical, differences in the measures (operating v annual payments) and relevant time periods (two preceding accounting periods v current and previous financial year).

But these are not the only levels of “smallness” which may be relevant for any NFP in meeting its financial reporting and audit requirements.

The Charities Act 2005 specifies that an audit by a qualified auditor is required (other than by a charitable organisation’s own rules) if a charity is “large” and an audit or review is required if a charity is “medium” (section 42C). Section 42D of that Act defines “large” by reference to total operating expenditure (not defined in the Act) of at least \$1.1million in each of the two preceding accounting periods; and “medium” by reference to total operating expenditure of at least \$550,000 in each of the two preceding accounting periods. Those provisions imply that a registered charity is “small” below that \$550,000 total operating expenditure threshold.

Many registered charities are incorporated societies. The current Incorporated Societies Act 1908 does not prescribe the content of financial statements or require audits. The new Incorporated Societies Act 2022 (“ISA2022”) and regulations yet to be made will impose more specific financial reporting and audit requirements than the present 1908 Act.

As I understand it, section 102 of the new ISA2022 will allow any society other than a “specified not-for-profit entity” to apply a non-GAAP standard, such as the current Tier 4 standard or a finalised ED 2022-6. But that Act also creates another level of “smallness” by creating a “small society”. Its criteria refer to not being a “donee organisation” for income tax purposes, total operating payments for each of the two preceding accounting periods of less than \$50,000 and total current assets at balance date for each of those periods of less than \$50,000. Such a “small society” could apply a non-GAAP standard or meet the section 104 requirements, which would, among other things, include stating all assets and liabilities at balance date. ISA2022 does not appear to define total operating payments or current assets. The basis and threshold for requiring an audit of an incorporated society is yet to be defined by regulations.

We therefore seem to have an ever-increasing number of pieces of legislation and regulation together with varying concepts and criteria of “smallness” which relate to accounting and audit requirements for NFPs. Compliance is becoming an increasing obstacle course for volunteers running NFPs.

It would be helpful to:

- Ensure there is consistency across the different sets of rules and
- Provide clarification via a “one stop shop” with a simple step-through for determining what incorporated NFPs below the Charities Act thresholds requiring audit or review must or can choose to do in relation to preparing their financial statements, reporting and filing under all applicable legislation.

Angela Williams
28 September 2022