Board of Administration of the Methodist Church of New Zealand

Submission on Tier 3 Not-For-Profit Reporting Requirements

Introduction

The Board of Administration of the Methodist Church of New Zealand (the Board) provides support services to the wider Church. The Board has been asked to manage 17 Funds on behalf of the Methodist Church Conference as at 30 June 2022. In addition to this the Board undertakes the accounting work for 24 other entities that report to The Conference and a further 14 entities that do not. That is, between 5 accountants and 4 accounting and administration support staff 55 "clients" accounts including their end of year financial statements.

In addition to that work, the Board engages a contract accountant to prepare an additional 43 sets of end of year financial statements. We have seen an increase in the number of Methodist Church and other Church related entities who are unable to undertake the compliance work required to keep the accounting and administration functions in their local communities.

For the Church as a whole, it files between 130 and 150 sets of financial statements as part of the Annual Return process with Charities Services. The Church has one set of financial statements that are required to file using Tier 1 reporting standards, 15 who use Tier 2 reporting standards, 90 who use Tier 3 with the balance using Tier 4. Only 22% of the financial statements are audited, 4% have a review with the balance not requiring an audit or review to be undertaken.

Objectives of Tier 3 Standard

We are unsure whether the primary users (Parish Councils, Boards of entities within the Church and other Board members and trustees) of the financial statements that are prepared using the Tier 3 reporting standards actually find the information relevant about the entity's performance. This is a question for the readers to decide and we have not undertaken any research into this aspect. However, from my own perspective what I have seen in practise is the use of templates to standardise the process of reporting to make the process as easy as possible and to also speed up the process. In my view most of the smaller entities do understand what is required, how to use the standards and therefore find the quickest means to complete the work.

Templating, in my view, does not get to the heart of what the objectives of the standards are attempting to obtain but they are a practical means to get the job done quickly in a very busy world.

What also needs to be taken into account when considering the inclusion of new compulsory categories (this goes to all of the categories on the Face of the Statement of Financial Performance and the Notes to the Accounts) is the significance of the item in comparison to other expense categories. Preparers must be given the freedom to use their judgement as to the current and proposed categories in light of the activities of the entity. The use of "required categories" moves away from the freedom to do.

Another aspect that we would ask the XRB to consider is what these changes will mean for Incorporated Societies when they are required to report using this this standard.

Service Performance Reporting

We agree with the proposals as we have attempted ourselves to break this part of the Tier 3 reporting standard down into:

- Why do you exist
- What are you trying to achieve in your community
- How do you try to achieve what you want, in a general sense
- What did you actually do during the year to move closer to these goals

The proposed wording moves in the direction that we have moved for a number of years but also have allowed us to adopt the requirements in IPSAS 48 which became effective this year.

Asset Valuation

The current wording in the Tier 3 reporting standard has been problematic and has led us to suggest to all Tier 3 and 4 prepares to use only the cost basis of recording assets. This has simply been done to reduce the need to introduce a Tier 2 reporting standard which add further complexity to many preparers who have little understanding of accounting concepts. Given the bulk of the preparers are not accountants nor know the basic accounting principles, the introduction of Tier 2 reporting standards would confuse preparers with unfamiliar concepts.

The option must remain to either use “cost” or the ”revaluation” model within the standard for each asset type.

There may be a need to discuss if there are benefits to have a middle ground for Tier 3 entities that are moving close to Tier 2 requirements. Some research into this group (Tier 3 entities whose operating expenditure is around the $1.5 to $1.75 million mark?) may be required to find our if these entities are prepared for the changes that may lie ahead.

Property, plant and equipment

The objective to have the ability to revalue, have the accounting policies and notes to the accounts that relate to that contained solely within the Tier 3 standards is acceptable but measured to what will be required if an entity moves closer to Tier 2 reporting standards.

I think making it clear that unless otherwise noted in the accounting policies, no reference should be made to the Tier 2 or 1 reporting standards. The audit and review standards may need to be changed to inform independent assurance providers that they should not make reference to the Tier 1 or 2 reporting standards as I have found that for some independent assurance providers, they have got lost in the Tier 2 standards and have lost the concept of being “simple”.

Investment property

The introduction of a separate class of asset, being an “investment property” maybe confusing for many of the preparers we are involved with. We see this as being additional compliance (another line in the Statement of Financial Position, changes in the fixed asset systems, etc.). In addition, assuming that this change is made, guidance will be required to preparers as to what to do with land and buildings currently accounted for in Property, plant and equipment (and being depreciated) and then moving it to Investment Property.

In the introduction to the consultation document there is reference is the need to reduce administration burden's and adding value. Will this change do this for the vast majority of primary users who we report to.

We have no issue if an entity believes there is value to them in separating out investment properties away from property, plant and equipment but I believe the proposed change needs to be reworded to give the option to move out investment properties, but it should not be a mandatory requirement based upon the definition.

Financial investments

Once again, this should be self-contained within the Tier 3 reporting standard with no reference to the Tier 2 standards. Also, "financial investments" is quite a broad term and can include a number of different investments some of which may be listed on one or more publicly available forums. In some cases they may not be listed, or they may be listed in more than one public forum and being differently calculated (i.e. bonds/company debentures) so flexibility is required and therefore the accounting policies regarding how the transactions are recording become important to understand what is being done and why.

Once again and entity should be given the choice of cost or revaluation.

Revaluations and Impairment Costs

The concept of having the revaluations flow directly to a revaluation reserve rather than through the Statement of Financial Performance is an understandable option as it would keep the Statement of Financial Performance "cleaner" and not need the development of a "Non-Operating", "Other Comprehensive Income and Expense" section which would add further confusion to readers. From an accounting perspective, flowing changes in the values of balance sheet items through the Statement of Financial Performance has been a hallmark of the accounting process and the suggested change seems to go back to what I would describe as "equity accounting".

However, we think that revaluations and impairment changes should be separate. They are two different concepts. Having some revaluations and impairment changes (both up and down) flow through Reserves in the Statement of Financial Position and some through the Statement of Financial Performance will add confusion to the ordinary preparer of the financial statements. A consistent approach is required. A flow diagram maybe helpful for users.

It could be that the concept of impairment may need to be reviewed and in what circumstances would both a revaluation (either up or down) also happens when an impairment be made?

Our concern comes from the approach the Methodist Church uses to distribute funds earned from its investments back to parishes and other entities within the Church. At the year end any realised or unrealised gains or losses are credited or debited to the parish deposits as a single amount (there is no breakdown into realised and unrealised amounts from a depositors viewpoint). In theory the parish is able to withdraw up to 90% of the deposit at any time but the deposit is viewed as a non-current asset as it held for longer periods for growth (more than one year). This deposit is the net result of the realised gains or losses. At present any net gains are shown as revenue through the Statement of Financial Performance. If the net result is a decretion (a deduction from the deposit) then that reduction in value is shown as "Other expenses". Where the amounts are significant for that parish it is shown as a separate line item in the Notes to the Accounts. Under the proposed changes both of these would flow directly through to accumulated funds as they are a type of "revaluation" of the deposit.

Categories for presenting revenue and expenses

The primary purpose of financial statements is for users to understand what has happened within the reporting entity. From our perspective it is much more important that the primary users of the financial statements are able to read and understand what is presented before them. The use of the financial statements by external users of the entity is a lower purpose. The external users do not bear the costs of preparation, presentation, audit or review and other compliance costs associated with the financial statements and so should be relegated to a lessor position. If an external user of the financial statements wishes to have additional information and they see value in that then they should be willing to fund that value. If the external user is an entity that provides grants to them, then they can ask for that additional information via the funding agreement. In that way not all entities are being burdened with additional compliance.

There is ample opportunity for reporting entities to change the descriptors of the presentation categories within the existing Tier 3 reporting standards but the issue, I feel is that the use of the red "*" has prevented this from happening, preparers have been unwilling to change the categories on the fear that they will be noncompliant or independent assurance providers have seen the red "*" as a must have and therefore a requirement, meaning that the flexibility within the current wording within the standards is not being used.

Sale of goods or services (commercial activities)

We are against this change as it does not add value to the readability of the accounts and may also mean that there are additional lines in the Statement of Financial Performance for the commercial and non-commercial activities. This adds further complexity to the accounts and requires the entity to make further judgements as whether the activity is commercial or non-commercial. Is the renting of a residential property a commercial activity if activity makes a surplus but the rent is not on commercial terms? Is the supply of social housing a commercial activity when its aim is for social good? How will this change impact upon incorporated societies?

There also seems to be a fine line between the sale of services at a profit and service delivery where it is partly funded by a grant and partly from fees charged and a surplus is made. Is the fact that a surplus is made enough to trigger the activity as being commercial in nature.

The other matter is what then happens when an entity moves from Tier 3 to Tier 2 as this breakdown then become irrelevant for the purposes of financial reporting. The focus is then on revenue from exchange and non-exchange transactions. Would it not be better for the Tier 3 standard to move in that direction instead so that larger Tier 3 reporting entities are working toward that breakdown.

Table 1 in the consultation document shows grants received. Within the current Tier 3 standards grants received is shown in one line. The proposal is to show them in 4 lines on the revenue side but on the expense side there is no linear way to show the costs associated with those grants received unless the preparer does that which would seem the logical thing to do. If the external user does indeed wish to see the breakdown of revenue as presented, then surely the reader also wants to know the costs associated with grants (except capital grants which by their nature may or may not flow through the Statement of Financial Performance depending on what the grant is used for).

In relation to Table 2 employee remuneration should include all employee related costs while the volunteer costs should be simply that. Does not seem logical to mix employee costs with volunteer costs. Also the proposed new categories could be detailed in the notes to the accounts rather than on the face of the Statement of Financial Performance as in some entities the cost may not be significant in relation to other costs and therefore should not take up space on the face of the Statement of Financial Performance.

Accumulated Funds

We do not believe that some of the increased disclosures will make a difference in the way many Tier 3 reporting entities manage their funds. Reserves are part of accumulated funds. The details of accumulated funds have flowed out of the Statement of Financial Performance. If users have issues with retention of funds, then those could have been voiced at the time the details were disclosed through that Statement, not years on. For many of the entities within the Church, large accumulated funds are shown but a large part will be taken up as revaluation reserves (or other designated reserves) and given the suggested changes in the consultation document revaluation reserves will increase. These revaluations cannot be "managed", they are simply an expression of the accounting system that requires a double entry system to occur. In addition to this, Tier 3 reporting standards do require disclosures of reserves already. Non accounting users see accumulated funds as "cash", that is the amount of "cash" that can be spent and do not appreciate the finer accounting points to what accumulated funds are.

Opting up

We agree with the suggestions, but it should also be noted that the Tier 1 and 2 reporting standards also refer to exchange and non-exchange transactions so opting up to a standard which requires a type of transaction to be recorded as a non-exchange transaction has a similar effect as other comprehensive income in my view.

Each of the Tier 1 and 2 reporting standards needs to be judged and dealt with to see if the classification systems used in those standards does not require a similar type of concession.

Other proposed amendments

Entity Information.

This should be retained. If it is changed then then the same logic should be carried into Tier 1 and 2 entities.

Statement of Cashflows

We would agree with the proposal as this would align itself with what occurs for many Tier 1 and 2 reporting entities.

Definition of "cash"

Agree with the proposal so long as the wording is self-contained within the Tier 3 standard without reference to the Tier 2 reporting standards. There also needs to be a mechanism for change so that when the Tier 2 reporting standard for Tier 2 is changed and the change impacts the definition of "cash" then this triggers a consequential change in the Tier 3 standard.

Effective date and other comments

Assuming that the exposure draft is finalised in early 2023 then an effective date of 1 April 2024 is fine BUT the sector must be given at least 12 months to prepare as all entities affected by the final changes will need to change their comparative information to comply which, for those entities currently being audited by, reviewed by ,an external assurance provider will mean extra costs, both internally to make the changes and externally for the audit.

In my view it may be better that the comparatives are left as they are with no reinstatement, but the changes happen only in the current year when the changes become effective.

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Board of Administration of the Methodist Church of New Zealand
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