



28 May 2021

Committee Secretariat
Economic Development, Science and Innovation Committee
Select Committee Services
Parliament Buildings
WELLINGTON 6160

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Incorporated Societies Bill

Dear Mr. Jamie Strange (MP) – Chair of the Economic Development, Science and Innovation Committee

Introduction

1. Thank you for the opportunity to submit our comments on the Incorporated Societies Bill (the 'Bill'). The External Reporting Board (XRB) is the independent Crown entity responsible for developing and issuing external reporting, auditing, assurance, and ethical standards in New Zealand. For further information on the XRB, please refer to [Appendix A](#).
2. The contribution of incorporated societies to the wellbeing of Aotearoa New Zealand is extensive and we welcome the work being done to modernise the legislation for incorporated societies. We believe the Bill achieves its goal of laying the basic framework of legal, governance, and accountability obligations for incorporated societies and those who run them. We agree that it is the members of a society who have the primary responsibility for holding the society to account. The proposals in the Bill will help those charged with governance (many of whom are volunteers) to appropriately lead these societies, be accountable to their members, and the wider communities they serve, in delivering on the objectives of incorporated societies.
3. Financial reporting plays an important role in providing accountability and transparency over a society's activities. The members of a society require appropriate financial information to hold those charged with governance accountable for the decisions they make. We, therefore, believe that the annual financial statements of all incorporated societies should be prepared in accordance with standardised reporting requirements as issued by an approved independent standard-setting body, which in New Zealand is the XRB. The XRB is charged with the responsibility for developing and issuing standards for all New Zealand entities with general purpose reporting requirements.
4. The main benefit of requiring all incorporated societies to report in accordance with standards issued by the XRB is that it will promote improved governance across the sector. The application of accounting standards that have been developed by an



independent Crown entity through consultation with both preparers and users will ensure that the information needs of society members and other stakeholders are met. In addition, the independent due process conducted by the XRB when developing accounting standards ensures that all reporting requirements are developed based on balancing cost/benefit considerations.

5. Requiring all incorporated societies to report in accordance with standards issued by the XRB will also promote a consistent level of reporting across the not-for-profit (NFP) sector. With consistent reporting to society members comes improved accountability, transparency, and decision-making by those charged with governance which will serve to increase the overall public trust in the sector.
6. The preparation of annual financial statements by all incorporated societies, based on accounting standards issued by an independent standard-setter, is important because societies often receive funding from members and the wider community and may also receive tax concessions and donations. We consider that financial statements prepared for incorporated societies are 'general purpose' because they are prepared by those charged with governance and are relied upon by its members and other external stakeholders.
7. The XRB has developed accounting standards specifically for NFP entities in accordance with its NFP Reporting Framework (refer to [Appendix B](#)). This Framework includes a tiered approach (Tiers 1 to 4) to ensure that the reporting requirements are appropriate for NFP entities of different sizes and nature – the smaller the entity, the simpler the reporting requirements. The accounting standards are subject to constant review by the XRB to ensure they are fit-for-purpose and updated for any changes in user needs. In contrast, it will be difficult to update specific reporting requirements established through legislation.
8. We are acutely aware that the cost of applying the reporting requirements prescribed in the XRB accounting standards must be exceeded by the benefits of applying such requirements, now and into the future. Indeed, we are currently reviewing the standards developed for smaller NFP entities (Tier 3 and Tier 4) to improve their usability, accessibility, and understandability.

Proposed reporting requirements for 'small' incorporated societies

9. We are pleased the Bill proposes that all incorporated societies prepare annual financial statements in accordance with standards issued by the XRB (Tier 1 – Tier 4), except for 'small' incorporated societies. However, we are concerned that 'small' incorporated societies would have the reporting option of either following XRB standards or following minimum reporting requirements as prescribed within the legislation (clause 97 of the Bill).
10. We recommend that the Bill be amended to remove the option that allows 'small' incorporated societies to prepare annual financial statements in accordance with minimum reporting requirements set out in clause 97. To support higher quality and

consistent reporting across the sector, we recommend that all societies be required to prepare their financial statements in accordance with accounting standards issued by the XRB.

11. Our recommendation is consistent with the recommendations provided in the Law Commission Report June 2013¹ and the proposals in the earlier draft of the Bill issued for public consultation in November 2015.²
12. The removal of the 'small' society reporting option, will result in most incorporated societies applying the standards within the XRB's NFP Reporting Framework ([Appendix B](#)) when preparing their annual financial statements. This Framework was independently developed by the XRB, based on user-needs research and public consultation across the NFP sector. The established Framework provides for 4 tiers of reporting requirements, which takes into account the size and relative complexity of the entities in those tiers. The reporting requirements for smaller entities are supported by optional template reports and additional guidance material in recognition that these entities often require increased support to ensure consistent application.
13. The existing Tier 3 and Tier 4 standards were developed by the XRB specifically for smaller NFP entities who are administered by volunteers with no formal accounting background, with a focus on ensuring the standards are simple to apply. Smaller incorporated societies would have the choice of using either the Tier 4 standard (which is cash based) or the Tier 3 standard (which is accrual based and may be more aligned with their current reporting) when preparing annual financial statements as required by the Bill.
14. We, therefore, do not consider it is necessary to create an additional reporting option for smaller incorporated societies through legislation. However, we acknowledge there is a need to regularly review our NFP standards (in particular Tier 3 and Tier 4) to ensure they remain fit for purpose (as discussed in the next section).

Responding to concerns that the XRB accounting standards would be difficult for 'small' incorporated societies to apply

15. We acknowledge that several submissions on the draft Bill published for public consultation in 2015 highlighted concerns that the proposal to require all incorporated societies to report in accordance with XRB accounting standards would introduce an unnecessary compliance burden for smaller societies.

¹ Recommendation 44: The requirements for annual reports should be determined by the External Reporting Board, with the standards applied to be in accordance with the Financial Reporting Act divisions (once enacted), including whether each society crosses any thresholds for size, complexity, or accountability.

² As per the MBIE November 2013 Request for Submissions: "Clause 83 is aimed at promoting higher quality and more consistent reporting by requiring all societies to prepare financial statements in accordance with accounting standards issued by the XRB. This means that incorporated societies will have the same preparation obligations as registered charities."

16. We have recently conducted a [Post-Implementation Review of our Simple Format Reporting Standards](#) (Tier 3 and Tier 4) which closed for comment on 31 March 2021. We received over 100 submissions and identified that, in general, respondents consider that the Tier 3 and Tier 4 reporting requirements are working as intended, are providing useful information, and have had a positive impact on the NFP sector. However, respondents also identified that the Tier 3 and Tier 4 standards need to be simplified further to improve their use and consistent application.
17. The XRB is currently reviewing its Tier 3 and Tier 4 standards, reporting templates, and accompanying guidance material in response to feedback received from the Post-Implementation Review. The review specifically includes consideration of simplifications to the existing NFP standards to ensure they provide appropriate reporting requirements for ‘small’ incorporated societies. The review and issuance of amended Tier 3 and Tier 4 standards will be completed before the new statutory reporting requirements for incorporated societies become effective.
18. The XRB is committed to ensuring the Tier 3 and Tier 4 standards are simple to apply and appropriate for smaller incorporated societies (which are often run by volunteers). This will be achieved through the simplification of existing requirements, removal of technical accounting terms, and providing additional guidance for those who require increased support. The objective is to ensure all incorporated societies are providing financial information to their members and other stakeholders that is appropriate for their size and nature.
19. In addition, the XRB will conduct awareness-raising activities to support the application of new reporting requirements for incorporated societies after the proposed legislation is enacted.

Lack of clarity in the proposed minimum reporting requirements for small societies

20. As discussed above, we recommend that the proposed option for ‘small’ incorporated societies to prepare annual financial statements following minimum reporting requirements (as set out in clause 97 of the Bill) be removed. However, if this option remains, we have some comments on how these minimum reporting requirements could be improved.
21. The proposed minimum reporting requirements in clause 97 are closely aligned with the existing requirements in section 23 of the Incorporated Societies Act 1908. The Bill proposes that small societies report ‘assets’ and ‘liabilities’, and ‘income’ and ‘expenditure’. However, the Bill does not explain how an entity then recognises and measures its transactions and balances and does not require societies to disclose their accounting policies. If the requirements in clause 97 are retained, we consider that the minimum requirements should specify how these items should be determined. This will help to promote consistent reporting and support improved transparency and accountability across the sector.

Income Tax Act requirements are more specific

22. One possibility would be to align the requirements in clause 97 more closely with the IRD's minimum financial reporting requirements for small companies.³ Table 1 below outlines some suggestions which would bring the proposals closer to the IRD's minimum requirements – additional text highlighted. It may be that more detail is intended to be provided in the regulations. Either way, we consider that it should be made clear that the minimum requirements in clause 97 of the Bill require the use of accrual double-entry accounting.

Table 1

<p>97 Minimum requirements for financial statements of small societies</p> <p>For the purposes of section 95(2)(b)(iii), the financial statements for an accounting period must—</p> <p>(a) contain the following information prepared on an accrual accounting basis:</p> <ul style="list-style-type: none">(i) a profit and loss statement showing income and expenditure of the society during the accounting period and comparable amounts for the previous period; and(ii) a balance sheet showing assets, liabilities and net assets of the society at the close of the accounting period and comparable amounts for the previous period;(iii) a statement of accounting policies, including a statement as to whether the financial statements have been prepared on a GST exclusive basis or not; and(iv) all mortgages, charges, and other security interests of any description affecting any of the property of the society at the close of the accounting period; and <p>(b) otherwise comply with requirements prescribed by the regulations.</p>

Contact details

23. If you have any queries or require clarification of any matter in this submission, please contact April Mackenzie, Chief Executive (P:+64 4 550 2048; E: april.mackenzie@xrb.govt.nz).

³ <https://www.ird.govt.nz/managing-my-tax/record-keeping/financial-reporting-for-companies/standards-for-minimum-financial-reporting>

Yours sincerely



Michele Embling
Chair
External Reporting Board



April Mackenzie
Chief Executive
External Reporting Board

Appendix A – The External Reporting Board (XRB)

XRB's Vision

The XRB's vision is that New Zealand prospers through effective decision making informed by high-quality, credible, integrated reporting. Our aim is to contribute to New Zealand's goal to create a sustainable, inclusive and prosperous economy. High-quality information is critical to ensuring decision making that impacts the wellbeing of New Zealand and New Zealanders is well informed.

Our strategy recognises that high quality information goes beyond financial information and includes non-financial elements of performance including value creation, sustainability, and the wider impacts an organisation has on society and the environment. When integrated, this information spans the natural, human, social, and financial capitals that support intergenerational wellbeing. We enable high quality, credible, and integrated reporting through the provision of robust frameworks and standards that are internationally credible, while being relevant to Aotearoa New Zealand so that reporting and assurance in New Zealand promote trust, confidence, transparency, and accountability.

XRB's Key functions

The External Reporting Board (XRB) is the independent Crown entity responsible for developing and issuing financial reporting, auditing, assurance, and ethical standards in New Zealand.

Legislation introduced by the Government determines who is required to report in accordance with generally accepted accounting practice (GAAP). The XRB is responsible for what these entities are required to report, being XRB Standards.

Under the Financial Reporting Act 2013, the XRB issues standards for all entities that are required, or opt, under law to prepare financial statements that comply with GAAP.

In issuing its standards, the XRB focuses on users' needs for information in general purpose financial reports (GPFR), that is, information intended to meet the needs of users who are not able to require an entity to prepare reports tailored to their particular information needs. In the case of incorporated societies, such users would be resource providers — including funders and donors — and members as recipients of services. The XRB undertakes various activities to ensure that it continues to set standards that meet the general purpose needs of users of financial reports, including undertaking due process consultation (as required under section 22 of the Financial Reporting Act 2013) and carrying out user-needs research.



Appendix B –XRB’s Existing NFP Reporting Framework

XRB’s NFP Reporting Framework		
Tier	Reporting tier criteria	Annual financial statement preparation requirements
Tier 1	<p>Applied by an incorporated society that:</p> <ul style="list-style-type: none"> • Has public accountability⁴; or • Has total expenses over \$30 million 	<p>Full NFP Standards</p> <ul style="list-style-type: none"> • NFP Standards issued by the XRB • Defined as a GAAP standards • These are accrual⁵ standards based primarily on International Public Sector Accounting standards (IPSAS[®])
Tier 2	<p>Applied by an incorporated society that has:</p> <ul style="list-style-type: none"> • No public accountability; and • Total expenses of less than \$30 million and over \$2 million 	<p>NFP Standards with reduced disclosures</p> <ul style="list-style-type: none"> • NFP Standards issued by the XRB • Defined as a GAAP standards • These are accrual-based standards based primarily on IPSAS, but with reduced information disclosure requirements
Tier 3	<p>Applied by an incorporated society that has:</p> <ul style="list-style-type: none"> • No public accountability; and • Total expenses of less than \$2 million and over \$125,000 operating expenses 	<p>Simple Format Accounting Requirements (Accrual-based)</p> <ul style="list-style-type: none"> • A single accrual-based accounting standard issued by the XRB • Defined as a GAAP standard • Optional template reports are provided (fill in the box approach)
Tier 4	<p>Applied by an incorporated society that has:</p> <ul style="list-style-type: none"> • No public accountability; and • Total operating payments of less than \$125,000 	<p>Simple Format Accounting Requirements (Cash-based)</p> <ul style="list-style-type: none"> • A single cash-based accounting standard issued by the XRB • Defined as a non-GAAP standard • Optional template reports are provided (fill in the box approach)

⁴ Entities with Public Accountability (as defined by XRB Standards) include those that have issued (or are about to issue) debt or equity instruments that are traded in a public market such as NZX listed entities. It also includes most banks, credit unions, insurance companies, and securities brokers/dealers.

⁵ Accrual reporting involves the reporting of revenue when earned and expenses when incurred, plus the reporting of assets, liabilities through double-entry accounting principles. This contrasts with cash-reporting which involves the recording of receipts when received (inwards cash) and payments when paid (outwards cash).