



BOARD MEETING AGENDA

9.30am to 3.30pm Wednesday 1 May 2019, XRB Office, Wellington

Est. Time	Item	Paper	Page
A: NON-PUBLIC SESSION			
10.30 am	Morning Tea		
12.30pm	Lunch		
B: PUBLIC SESSION			
	<i>For approval:</i>		
	2.10 Appendix A of XRB A1		
	2.10.1 Appendix A of XRB A1- Cover Memo XRB	Paper	
	2.10.2 Appendix A of XRB A1- Cover Memo NZASB	Paper	
	2.10.3 Amended Appendix A of XRB A1	Paper	
	2.10.4 Submissions on Exposure Draft	Paper	
	2.11 Review of Charities Act 2005 – Draft submission		
	2.11.1 Cover Memo - Review of Charities Act 2005	Paper	
	2.11.2 Modernising the Charities Act 2005 Quick Read	Paper	
	2.11.3. Modernising the Charities Act 2005 Discussion Document	Paper	
	2.11.4 Draft Submission on Review of Charities Act 2005	Paper	
C: NON-PUBLIC SESSION			
3.30 pm	Close		

Next Meeting: 19 June 2019, Wellington



EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

DATE: 18 April 2019
TO: Members of the External Reporting Board
FROM: Tracey Crookston and Vanessa Sealy Fisher
SUBJECT: **2019 Amendments to XRB A1 Appendix A**

Purpose and introduction

1. The purpose of this agenda item is to seek the XRB Board's approval of *2019 Amendments to XRB A1 Appendix A*,¹ subject to any amendments arising from the NZASB's consideration and approval of this standard at its meeting to be held on 2 May 2019.
2. Appendix A of XRB A1 *When is an Entity a Public Benefit Entity?* (Appendix A) provides guidance to assist an entity to determine whether it is a public benefit entity (PBE) or a for-profit entity for financial reporting purposes. The correct classification is important to enable an entity to apply the appropriate set of accounting standards (i.e. PBE Standards or NZ IFRS).

Due process

3. An exposure draft (ED) was issued by the XRB Board in December 2018. Comments were due by 29 March 2019.
4. The changes in the ED were proposed because:
 - (a) some of the guidance in Appendix A was based on guidance that existed prior to the development and issuance of the New Zealand Accounting Standards Framework. Now that this Framework has been operational for some time, it is appropriate to review the guidance; and
 - (b) some constituents have experienced difficulties in applying Appendix A.
5. Submissions have been received from the following respondents (agenda item 2.10.4):

R#	Name of Respondent
R1	Auckland Council
R2	BDO
R3	Carolyn Cordery
R4	Office of the Auditor-General (OAG)
R5	Respondent 5 (informal comments)
R6	Respondent 6 (informal comments)

6. Respondents R1, R2, R3 and R5 answered the three specific questions in the Invitation to Comment. Respondent R5 also provided comments on the illustrative

¹ The ED was issued as *2018 Amendments to XRB A1 Appendix A*. The standard is titled *2019 Amendments to XRB A1 Appendix A* as this is the year the amendments will be finalised.

examples. Respondents R4 and R6 provided comments and suggestions on specific matters rather than responding to specific questions.

7. R1, R2, R3 and R5 all answered in the affirmative to Questions 1 and 2. Question 1 asked whether respondents agreed with the proposed amendments to XRB A1 Appendix A *When is an Entity a Public Benefit Entity?* Question 2 asked whether respondents agreed with the proposed effective date of 1 January 2020. R3 also questioned the use of some terminology.
8. Staff are not proposing any amendments other than the inclusion of Basis for Conclusion (BC) paragraphs in XRB A1 to outline the changes made to Appendix A.
9. The matters raised by respondents and staff responses to those matters are briefly summarised below. These matters are covered in more detail in the New Zealand Accounting Standards Board (NZASB) memo included in these agenda papers (agenda item 2.10.2).

Matters raised	Staff response
Terminology	
<p>In most of the sections (para 24, 29, 32, 34 and in respect of multiple objectives in para 19), there is a statement that an 'entity is likely to be a PBE'. Yet in paras 14–16 no such statements are provided. If they were, it would provide a purpose for these examples.</p>	<p><u>We have recommended no change.</u> Paragraphs 14 to 16 provide examples of legislation and founding documents that may specify the detailed objectives of an entity. The purpose of the guidance here is to clarify where an entity should look to clarify its stated objectives rather than to indicate whether these documents (SOE Act, DHB objectives, Charities Act 2005) help to determine whether the entity is a PBE.</p>
The term "equity holders" does not easily fit all situations	
<p>The paragraphs regarding purpose and use of assets could be enhanced by explaining what is meant by the term "equity holders" in non-company structures or using terminology that can apply across different types of entity in the public sector.</p> <p>There are non-company structures such as trusts which do not have "equity holders", in a traditional sense, and where financial benefits are being generated.</p>	<p><u>We have recommended no change.</u> This indicator is dealing with the purpose and use of the assets held by the entity rather than the nature of the equity interest (i.e. how is the entity using the assets held and for what purpose – for a community benefit or a return to equity holders).</p> <p>Paragraphs 30 and 31 also refer to equity holders when discussing the indicator Nature of equity interest, and state that the absence of clear equity holders may manifest itself in a number of ways.</p> <p>Paragraph 11 states that in many cases it will be unlikely that any one indicator will be conclusive in determining whether an entity meets the definition of a PBE and it may be necessary to consider several indicators together.</p>

Matters raised	Staff response
	Considering and balancing the assessment of each indicator is a matter of professional judgement.
The Quantum of Expected Financial Surplus is a Strong Indicator	
The updated Appendix should include a discussion that the quantum of the expected financial benefits will usually provide a strong indication whether an entity is a PBE.	<p><u>We have recommended no change.</u> Elevating one indicator above others would conflict with the guidance in paragraph 11.</p> <p>The reason for merging the original indicator (quantum of the expected financial surplus) with the nature of the benefits was to provide guidance to ensure that all benefits (not just financial) are considered in the assessment.</p>
A change in classification could be a for-profit entity becoming a PBE	
Paragraph 40 should include an example of a for-profit entity becoming a public benefit entity.	<p><u>We have recommended no change.</u> The Board agreed not to include an example of the reclassification of a for-profit entity to a public benefit entity because the number of possible scenarios resulted in the paragraph becoming unwieldy. The move from a public benefit entity to a for-profit entity was considered a more likely scenario in the New Zealand context.</p>
The reasons for the changes to XRB A1 Appendix A should be explained	
The proposed amended XRB A1 Appendix A does not include a Basis for Conclusions. It is important to explain the reasons for the significant changes to Appendix A and, in particular, the inclusion of the purpose and use of assets indicator.	<p><u>We have recommended that a Basis for Conclusions (BC) on the amendments to Appendix A of XRB A1 be added.</u></p>
Illustrative Examples	
In the new illustrative example, it would be useful to consider both parts of the test (primary objective and provision of equity) rather than just the indicators.	<p><u>We have recommended no change.</u> The purpose of the indicators is to help an entity to determine whether it meets the definition of a PBE in XRB A1. The new illustrative example is consistent with the other illustrative examples in that the indicators in Appendix A are applied to the facts in the example.</p>
We would appreciate further guidance in the Appendix on assessing whether a consolidated group is a PBE (i.e. whether the ultimate controlling entity	<p><u>We have recommended no change.</u> Determining the classification of a consolidated group depends on a range of facts and circumstances and it would</p>

Matters raised	Staff response
and consolidated reporting entity is a PBE). This could help with mixed groups.	not be possible to consider all the relevant facts and circumstances while at the same time keeping the example simple and ensuring it continues to be widely applicable.
Shareholder equity interests	
It would be good if the guidance around shareholder equity interests could be made clearer (as we have charitable companies within charitable groups) and when there are reporting obligations by those companies (for various reasons).	<p><u>We have recommended no change.</u></p> <p>Paragraphs 30 and 31 refer to equity holders when discussing the indicator Nature of equity interest, and state that the absence of clear equity holders may manifest itself in a number of ways.</p> <p>Paragraph 11 states that in many cases it will be unlikely that any one indicator will be conclusive in determining whether an entity meets the definition of a PBE and it may be necessary to consider several indicators together. Considering and balancing the assessment of each indicator is a matter of professional judgement.</p>
Does an equity interest in shares that provide a return prohibit PBE classification absolutely?	
<p>The proposals clarify that both limbs must be met; as such with the second limb – “(ii) <i>the provision of any equity is to support the primary objective rather than for a financial return to equity holders</i>” – could be read to suggest that any equity that provides any level of return might prevent a PBE classification.</p> <p>Is this the intention, or is judgement able to be applied to the substance – perhaps with a nature/scale override?</p>	<p><u>We have recommended no change.</u></p> <p>The second leg of the definition of a PBE does not deal with the level of return obtained on equity. Rather, it deals with the primary objective of the entity and whether that equity is provided to the entity to enable the entity to meet its primary objective.</p> <p>Many entities aim to generate revenues in excess of expenses. Further, in order to continue operating, entities need to at least break even over the long term.</p>
Scale of equity – vs level of return provided by equity	
There is now a reference to the scale of equity in the guidance – but perhaps scale of equity return is more relevant? As whether the share capital is \$100 or \$1,000,000 doesn’t really indicate nature. (This is relative to the text within para 38: <i>for example, if the entity has only a small amount of equity, considering the nature of its equity interest may be less helpful than the other indicators when determining whether, in</i>	<p><u>We have recommended no change.</u></p> <p>The reference to the small amount of equity is used to illustrate that, in these circumstances, considering the nature of the equity interest may be less helpful than the other indicators when determining whether, in substance, the entity meets the definition of a PBE.</p>

Matters raised	Staff response
<p><i>substance, the entity meets the definition of a PBE).</i></p> <p>Would a more relevant consideration perhaps be whether the level of return provided by the equity is what an arms-length commercial investor would seek?</p>	

10. The due process followed by this project complies with the due process requirements established by the XRB Board and, in the staff's view, meets the requirements of section 22 of the Financial Reporting Act 2013.
11. In accordance with section 22(2) of the Financial Reporting Act 2013 the NZASB will consider whether the amending standard is likely to require the disclosure of personal information. The NZASB will be advised by staff that, in their view, the amending standard does not include requirements that would result in the disclosure of personal information and therefore no consultation with the Privacy Commissioner is required.

Scope, RDR and effective dates

12. The amended Appendix A will be applicable to all entities required to prepare GPFR in accordance with XRB standards.
13. Appendix A does not contain disclosure requirements; therefore RDR concessions are not needed.
14. The amendments are effective for periods beginning on or after 1 January 2020, with earlier application permitted.

Consistency with XRB Financial Reporting Strategy

15. The amendments to Appendix A are consistent with the Accounting Standards Framework.
16. The amendments do not affect harmonisation with Australia for for-profit entities. XRB A1 is a domestic standard dealing with the application of the New Zealand Accounting Standards Framework by entities that report in New Zealand.

Other matters

17. There are no other matters relating to this amending standard that the NZASB considers are pertinent or that should be drawn to your attention.

Recommendation

18. We recommend that the XRB Board APPROVES for issue *2019 Amendments to XRB A1 Appendix A*, subject to any amendments arising from the NZASB meeting on 2 May 2019.
19. If changes are needed to the standard as a result of the discussions at the NZASB meeting, those changes will be made and circulated to XRB Board members for approval.

Attachments

Agenda item: 2.10.2 Memo to the NZASB
 2.10.3 *2019 Amendments to XRB A1 Appendix A*
 2.10.4 Submissions on XRB A1 Appendix A



NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date: 18 April 2019

To: Members of the New Zealand Accounting Standards Board

From: Tracey Crookston and Vanessa Sealy-Fisher

Subject: **Appendix A of XRB A1**

Recommendations

1. We recommend that the Board:
 - (a) CONSIDERS the feedback received on XRB ED *2018 Amendments to XRB A1 Appendix A* (the ED);
 - (b) AGREES with our recommendations to make no changes to the proposals in the ED, other than to add a Basis for Conclusions;
 - (c) NOTES the submissions received on the ED; and
 - (d) APPROVES *2019 Amendments to XRB A1 Appendix A*,¹ as submitted to the XRB Board for approval to issue.

Background

2. At its meeting in December 2018, the XRB Board approved for issue XRB ED *2018 Amendments to XRB A1 Appendix A*.
3. The ED was issued in December, with comments due by 29 March 2019. Submissions have been received from the following respondents (see agenda items 5.3.1–5.3.6).

<i>R#</i>	<i>Name of respondent</i>	<i>Agenda item</i>
R1	Auckland Council	5.3.1
R2	BDO	5.3.2
R3	Carolyn Cordery	5.3.3
R4	Office of the Auditor-General (OAG)	5.3.4
R5	Respondent 5 (informal comments)	5.3.5
R6	Respondent 6 (informal comments)	5.3.6

¹ The ED was issued as *2018 Amendments to XRB A1 Appendix A*. The standard is titled *2019 Amendments to XRB A1 Appendix A* as this is the year the amendments will be finalised.

Analysis of submissions

4. Respondents R1, R2, R3 and R5 answered the three specific questions in the Invitation to Comment. Respondent R5 also provided comments on the illustrative examples while respondents R4 and R6 provided comments and suggestions on specific matters rather than responding to the specific questions. These issues and our response to those issues are outlined below.
5. R1, R2, R3 and R5 all answered in the affirmative to Questions 1 and 2. Question 1 asked whether respondents agreed with the proposed amendments to XRB A1 Appendix A *when is an Entity a Public Benefit Entity?* Question 2 asked whether respondents agreed with the proposed effective date of 1 January 2020. R3 and R5 also raised other matters which are outlined in the table below.

Issues raised by respondents

6. The following issues were raised by respondents.

R#	Issue (extracted from submission)	Staff recommendations and comments
R3	<p>Terminology</p> <p>I note that in most of the sections (para 24, 29, 32, 34 and in respect of the multiple objectives in para 19), there is a statement that an entity is 'likely to be a PBE'. Yet paras 14–16 no such statements are provided. If they were, it would provide a purpose for these examples.</p>	<p><u>We recommend no change.</u></p> <p>Paragraphs 14 to 16 provide examples of legislation and founding documents that may specify the detailed objectives of an entity. The purpose of the guidance here is to clarify where an entity should look to clarify its stated objectives rather than to indicate whether these documents (SOE Act, DHB objectives, Charities Act 2005) help to determine whether the entity is a PBE.</p>
R4	<p>The term “equity holders” does not easily fit all situations</p> <p>The purpose and use of assets (paragraph 32) notes that the reason an entity acquires and/or holds an asset may indicate whether it is a public benefit entity. This paragraph further elaborates that for-profit entities hold assets mainly for sale or for generating a financial benefit for equity holders.</p> <p>However, there are non-company structures such as trusts which do not have “equity holders”, in a traditional sense, and where financial benefits are being generated.</p> <p>For example, licensing trusts operate in a commercial manner to maximise financial returns. However, they are community organisations in the sense that any surplus profits must be used for community or philanthropic purposes.</p> <p>We recommend that the paragraphs regarding purpose and use of assets could be enhanced by clearly explaining what is meant by the term “equity holders” in non-company structures, or</p>	<p><u>We recommend no change.</u></p> <p>Paragraph 32 acknowledges R4’s point and notes that “The primary reason PBEs (particularly public sector PBEs) hold property, plant and equipment and other assets (including infrastructure assets) is usually for their potential to provide future services for community or social benefit rather than their ability to generate a financial benefit for equity holders”.</p> <p>This indicator is dealing with the purpose and use of the assets held by the entity rather than the nature of the equity interest (i.e. how is the entity using the assets held and for what purpose – for a community benefit or for a return to equity holders).</p> <p>Paragraphs 30 and 31 also refer to equity holders when discussing the indicator nature of equity interest, and states that the absence of clear equity holder may manifest itself in a number of ways.</p> <p>Paragraph 11 states that in many cases it will be unlikely that any one indicator will be conclusive in determining whether an entity meets the</p>

R#	Issue (extracted from submission)	Staff recommendations and comments
	using terminology that can apply across different types of entity in the public sector.	definition of a PBE, and it may be necessary to consider several indicators together. Considering and balancing the assessment of each indicator is a matter of professional judgement.
R4	<p>The quantum of expected financial surplus is a strong indicator</p> <p>The current version of XRB A1 – paragraph 11 of Appendix A includes the indicator “<i>the quantum of expected financial surplus</i>.” This has been combined with the indicator “<i>Nature of the benefits</i>” in the updated appendix.</p> <p>Some of the text of the previous <i>quantum of expected financial surplus</i> indicator (which is now part of the nature of the benefits) has been deleted – namely the sentence in paragraph 20 “The quantum of the expected surplus will provide a strong indication whether an entity is a PBE.”</p> <p>From our perspective, this sentence has proved to be both relevant and useful. We have found it helpful when considering judgement calls about whether an entity is a public benefit entity.</p> <p>We recommend that the updated appendix include discussion that the quantum of the expected financial benefits will usually provide a strong indication whether an entity is PBE.</p>	<p><u>We recommend no change.</u></p> <p>The Appendix sets out a series of indicators to be considered when assessing an entity’s classification. At a principles level no one indicator should be elevated above the others. Rather, determining which indicator(s) have more weight in a particular set of circumstances is a matter of professional judgement when assessing the classification of a specific entity. Adding the words “The quantum of the expected surplus will provide a strong indication whether an entity is a PBE.” could result in more emphasis being placed on this indicator compared with other indicators.</p> <p>Elevating one indicator above others would also conflict with the guidance in paragraph 11 which states “This Appendix sets out several indicators to be considered in determining whether an entity meets the definition of a PBE. In many cases it will be unlikely that any one indicator will be conclusive in determining whether an entity meets the definition of a PBE, and it may be necessary to consider several indicators together. Professional judgement is required when considering and balancing the assessment of each indicator”.</p> <p>The standard has merged the original indicator (quantum of the expected financial surplus) with the nature of the benefits to provide guidance that ensures that all benefits are considered in the assessment, not just financial benefits.</p>
R4	<p>A change in classification could be a for-profit entity becoming a PBE</p> <p>Paragraph 40 includes an example of an entity’s classification changing from a public benefit entity to a for-profit entity. We recommend that paragraph 40 also include an example of a for-profit entity becoming a public benefit entity. For example, if a Tier 1 or 2 for-profit entity becomes a Tier 1 or Tier 2 public benefit entity, the entity would need to apply PBE FRS-46 <i>First-time Adoption of PBE Standards by Entities Previously Applying NZ IFRS</i>.</p>	<p><u>We recommend no change.</u></p> <p>We had previously included a sentence to this effect in an earlier version of the ED.</p> <p>The Board agreed not to include reclassification of a PBE to a for-profit entity because the number of possible scenarios resulted in the paragraph becoming unwieldy (e.g. if a for-profit entity meets the criteria to report in accordance with Tier 3 or Tier 4, it would not apply PBE FRS 46 or PBE FRS 47). Furthermore, the Board has a project on its work plan to consider whether it is appropriate to combine the requirements in PBE FRS 46 and PBE FRS 47 to reduce confusion for entities when determining which standard is appropriate when a Tier 1 or Tier 2 for-profit entity changes its classification to become a Tier 1 or Tier 2 PBE.</p>

R#	Issue (extracted from submission)	Staff recommendations and comments
		The move from a public benefit entity to a for-profit entity was considered a more likely scenario in the New Zealand context.
R4	<p>The reasons for the changes to XRB A1 Appendix A should be explained</p> <p>We note that the proposed amended XRB A1 Appendix A does not include a basis for conclusions. We think it is important to explain the reason for the significant changes to XRB A1 Appendix A, and in particular the inclusion of the indicator regarding the purpose and use of assets.</p> <p><i>Purpose and use of assets indicator</i></p> <p>The purpose and use of assets is an important indicator because applying existing indicators has led to judgements about entities not being considered public benefit entities, which has resulted in illogical asset accounting. An example of illogical accounting of assets is the situation where an entity reports using for-profit accounting standards and each year acquires and capitalises assets only to impair (or write off) the assets because the cash flows from the assets do not support their cost.</p> <p>We recommend the purpose and use of assets indicator include a discussion that if an entity's primary objective is to operate an asset, such as infrastructure, and any new investment in that asset is not supported by future cash flows generated from the asset, this provides a strong indication an entity is a PBE.</p>	<p><u>We propose to include a Basis for Conclusions on the amendments to Appendix A of XRB A1.</u></p> <p>However, the Basis for Conclusions is unlikely to be as detailed as R4 has requested. As discussed above, all the indicators have equal standing and an entity considers all the indicators when determining whether it is a PBE.</p> <p>The BC section, consistent with other NZASB and XRB Standards, is drafted at a higher level.</p> <p>While classification anomalies should be the exception rather than the norm, there may be classification anomalies:</p> <ul style="list-style-type: none"> (a) because of complexities around the classification for certain entities; and (b) due to operating in a multi-standards framework. <p>Using the words "...provides a strong indication an entity is a PBE" under this indicator effectively elevates one indicator above others and conflicts with the guidance in paragraph 11.</p>
R5	<p>Illustrative examples</p> <p>In the new illustrative example, we consider it useful to consider both parts of the test (primary objective and provision of equity) rather than just the indicators.</p>	<p><u>We recommend no change.</u></p> <p>The purpose of the indicators is to help an entity to determine whether it meets the definition of a PBE in XRB A1. The new illustrative example is consistent with the other illustrative examples in that the indicators in Appendix A are applied to the facts in the example.</p>
	<p>Furthermore, we would appreciate further guidance in the Appendix on assessing whether a consolidated Group is a PBE. i.e. whether the ultimate controlling entity and consolidated reporting entity is a PBE. This may be helpful for examples where charitable trusts control the main operating for-profit entity or where you have a mix of reporting entities consolidated into the Group.</p>	<p><u>We recommend no change.</u></p> <p>We acknowledge the respondent's concern. However, Appendix A is principles-based and requires the application of professional judgment when determining whether an entity is a PBE. The illustrative examples show the application of the indicators in Appendix A to specific sets of facts and circumstances.</p> <p>To be useful, we think illustrative examples should be simple and have wide applicability across a range of different situations and different entity types. Determining the classification of a consolidated group depends on a range of facts and circumstances and we think</p>

R#	Issue (extracted from submission)	Staff recommendations and comments
		it would not be possible to consider all relevant facts and circumstances while at the same time keeping the example simple and ensuring it continues to be widely applicable.
R6	<p>Shareholder equity interests</p> <p>If possible, it would be good if the guidance could be clearer around shareholder equity interests, as we have charitable companies within charitable groups, and when there are reporting obligations by those companies (for various reasons).</p>	<p><u>We recommend no change</u></p> <p>Paragraphs 30 and 31 refer to equity holders when discussing the indicator nature of equity interest, and state that the absence of clear equity holders may manifest itself in a number of ways.</p> <p>Paragraph 11 states that in many cases it will be unlikely that any one indicator will be conclusive in determining whether an entity meets the definition of a PBE, and it may be necessary to consider several indicators together. Considering and balancing the assessment of each indicator is a matter of professional judgement.</p>
R6	<p>Does an equity interest in shares that provide a return prohibit PBE classification absolutely?</p> <p>The proposals clarify that both limbs must be met; as such with the second limb – “(ii) the provision of any equity is to support the primary objective rather than for a financial return to equity holders” – could be read to suggest that any equity that provides any level of return might prevent a PBE classification.</p> <p>Is this the intention, or is judgement able to be applied to the substance – perhaps with a nature/scale override?</p>	<p><u>We recommend no change.</u></p> <p>The second leg of the definition of a PBE – the provision of any equity is to support the primary objective rather than for a financial return to equity holders – does not deal with the level of return obtained on equity. Rather, it deals with the primary objective of the entity and whether that equity is provided to the entity to enable the entity to meet its primary objective.</p> <p>Many entities aim to generate revenues in excess of expenses. Furthermore, in order to continue operating all entities need to at least break even over the long term.</p>
R6	<p>Scale of equity – vs level of return provided by equity</p> <p>There is now a reference to the scale of equity in the guidance – but perhaps scale of equity return is more relevant? As whether the share capital is \$100 or \$1,000,000 doesn’t really indicate nature.</p> <p>(This is relative to the text within para 38: <i>for example, if the entity has only a small amount of equity, considering the nature of its equity interest may be less helpful than the other indicators when determining whether, in substance, the entity meets the definition of a PBE. [based on paragraph 27])</i></p> <p>Would a more relevant consideration perhaps be whether the level of return provided by the equity is what an arms-length commercial investor would seek?</p>	<p><u>We recommend no change.</u></p> <p>Paragraph 38 provides guidance when there are conflicting indicators in determining the classification of an entity.</p> <p>The reference to the small amount of equity is used to illustrate that, in these circumstances, considering the nature of the equity interest may be less helpful than the other indicators when determining whether, in substance, the entity meets the definition of a PBE.</p>

Question for the Board

Does the Board agree with the recommendations to not make changes to Appendix A of XRB A1 other than the inclusion of a Basis for Conclusions?

Due process

7. The due process followed by this project complies with the due process requirements established by the XRB Board and meets the requirements of section 22 of the Financial Reporting Act 2013.
8. In accordance with section 22(2) of the Financial Reporting Act 2013 the amending standard does not include requirements that would result in the disclosure of personal information and therefore no consultation with the Privacy Commissioner is required.

Next steps

9. At its meeting on 1 May, the XRB Board is being asked to approve the issue of *2019 Amendments to XRB A1 Appendix A*, subject to the NZASB also approving the amendments.
10. If necessary, Appendix A will be updated for feedback received and circulated to the XRB Board for approval to issue.

Question for the Board

Does the Board approve *2019 Amendments to XRB A1 Appendix A* for submission to the XRB Board for approval to issue?

Attachments

Agenda item 5.2: Cover memo to XRB Board for approval of *2019 Amendments to XRB A1 Appendix A*

Agenda item 5.3: Submissions received

- 5.3.1: Auckland Council
- 5.3.2: BDO
- 5.3.3: Carolyn Cordery
- 5.3.4: Office of the Auditor-General
- 5.3.5: Respondent 5
- 5.3.6: Respondent 6

Agenda item 5.4: *2019 Amendments to XRB A1 Appendix A*



EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

2019 AMENDMENTS TO XRB A1 APPENDIX A

This Standard was issued on [date] by the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on [date].

Reporting entities that are subject to this Standard are required to apply it in accordance with the effective date, which is set out in Part D.

In finalising this Standard, the External Reporting Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Standard has been issued to update and improve the guidance in Appendix A of XRB A1 *Application of the Accounting Standards Framework*. The title of Appendix A is *When is an Entity a Public Benefit Entity?*

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Part A: Introduction

This Standard includes amendments to:

- (a) the guidance on the definition of a PBE to clarify that:
 - (i) the definition contains two interdependent parts and both parts of the PBE definition need to be assessed when determining an entity's classification;
 - (ii) the classification as a PBE or for-profit entity is made at the entity level. As a result, the classification at the entity level may differ from the classification at the group level; and
 - (iii) it is possible for an entity to be classified as a for-profit entity for financial reporting purposes and to be a registered charity.
- (b) the indicators to be considered in determining whether an entity is a PBE. Specifically:
 - (i) 'stated objectives' replaces 'founding documents' but includes reference to founding documents;
 - (ii) guidance is added on consideration of the entity's assessment of performance where an entity has multiple objectives;
 - (iii) 'Nature of the benefits, including the quantum of expected financial benefits' now includes the principles previously described under both the 'Nature of the benefits' and the 'Quantum of expected financial surplus' (now deleted) indicators;
 - (iv) a new indicator 'Primary beneficiaries of the benefits' has been added;
 - (v) a new indicator 'Purpose and use of assets' has been added; and
 - (vi) the 'Nature of funding' indicator includes more guidance.
- (c) the paragraphs on conflicting indicators, to explain that professional judgement is required to evaluate the indicators overall and in combination with each other, including the significance of particular indicators to the overall assessment.
- (d) the paragraphs under 'Changing classification', to refer back to relevant paragraphs in XRB A1 *Application of the Accounting Standards Framework* for determining the applicable tier of financial reporting when an entity changes its classification.
- (e) update the illustrative examples and to add a new illustrative example.

Part B: Scope

This Standard applies to entities that prepare, or opt under an enactment to prepare, GPFR in accordance with accounting standards issued by the XRB.

Part C: Amendments to XRB A1

Paragraph 76 is added.

76. 2019 Amendments to XRB A1 Appendix A, issued in Month 2019, replaced Appendix A. That amendment is effective for reporting periods beginning on or after 1 January 2020. Earlier application of the revised Appendix A is permitted.

Appendix A is replaced as shown below.

APPENDIX A

WHEN IS AN ENTITY A PUBLIC BENEFIT ENTITY?

This appendix forms an integral part of XRB A1 Application of the Accounting Standards Framework.

Purpose

- 1 The purpose of this Appendix is to assist an entity that prepares a general purpose financial report (GPFR) that complies with accounting standards issued by the External Reporting Board (XRB) to determine whether or not it is a public benefit entity (PBE).
- 2 The classification of an entity as a for-profit entity or a PBE is important because it determines which accounting standards and related accounting policies are applied by an entity. Inappropriate classification may result in the adoption of inappropriate accounting policies, and a failure to provide users with information appropriate to assessing the financial performance, financial position and service performance of an entity.

Definition of a PBE

- 3 XRB A1 defines PBEs as “reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.” PBEs may be public sector entities or not-for-profit entities.
- 4 The following definitions for public sector PBEs and not-for-profit PBEs are contained in XRB A1:
 - (a) Public sector PBEs are PBEs that are public entities as defined in the Public Audit Act 2001, and all Offices of Parliament; and
 - (b) Not-for-profit PBEs are PBEs that are not public sector PBEs.
- 5 For-profit entities are not defined. Rather, the term for-profit entities encompasses all entities other than PBEs. An entity must assess whether it is a PBE or a for-profit entity by considering whether or not it meets the definition of a PBE. Assessing whether an entity meets the definition of a PBE requires an entity to determine its primary objective.
- 6 In many cases it will be obvious whether an entity meets the definition of a PBE. For example, most charities registered under charities legislation are likely to meet the definition of a PBE, although it is possible for a registered charity to be classified as a for-profit entity for financial reporting purposes. Similarly, many public sector entities operate under legislation that specifically requires them to provide goods or services for the benefit of the public. For example, the New Zealand Public Health and Disability Act 2000 requires this for District Health Boards.
- 7 In other cases it will not be immediately obvious that an entity is a PBE. Determining the primary objective of the entity (i.e. why the entity exists and what it intends to achieve) can be difficult where an entity has

multiple objectives and such objectives are not ranked, or where the objectives are not clearly stated. In identifying the primary objective, it is necessary to assess the substance of the entity's purpose.

- 8 In this regard, it should be noted that the definition of a PBE comprises two interdependent parts: (i) the primary objective to provide goods or services for community or social benefit, and (ii) the provision of any equity is to support that primary objective rather than for a financial return to equity holders. Both parts of the definition need to be assessed in combination in determining an entity's classification. Assessing one of the parts alone is unlikely to be sufficient in determining whether an entity is a PBE or a for-profit entity.
- 9 The legal form of an entity is unlikely to be a conclusive factor in determining whether or not an entity is a PBE. PBEs are constituted in many different forms such as incorporated societies, trusts, statutory bodies and even companies. PBEs include a wide range of entity types, including charities, clubs, and non-commercial public sector entities. They exist in the private sector and in the public sector and may be small or large.
- 10 Also, although in general terms PBEs exist to provide goods and services for the community or social benefit, this does not necessarily imply that such entities exist for the benefit of the public as a whole. Many PBEs exist for the direct benefit of a particular group of people, although it is also possible that society as a whole benefits indirectly. For example, a community football club exists to promote and encourage football for the direct benefit of its members. However, society as a whole may also benefit indirectly through a healthier population and through the provision of organised activities for its youth.
- 11 This Appendix sets out several indicators to be considered in determining whether an entity meets the definition of a PBE. In many cases it will be unlikely that any one indicator will be conclusive in determining whether an entity meets the definition of a PBE and it may be necessary to consider several indicators together. Professional judgement is required when considering and balancing the assessment of each indicator.
- 12 The assessment for classification as a PBE or as a for-profit entity is made at the reporting entity level. As a result, the classification at the reporting entity level may differ from the classification at the group level. Therefore, where an entity is a subsidiary of another entity and the subsidiary entity is a reporting entity with its own reporting obligations, the subsidiary assesses its own primary objective for reporting purposes. In determining the classification of a group, it is necessary to consider the characteristics of the group. The classification of the controlling entity of the group would most likely determine the classification of the group.

Indicators

- 13 Paragraphs 14 to 37 discuss key indicators that aim to focus on the substance of an entity's purpose and which should be considered in determining whether an entity is a PBE. These indicators are:
 - the stated objectives;
 - the nature of the benefits, including the quantum of expected financial benefits;
 - the primary beneficiaries of the benefits;
 - the nature of any equity interest;
 - the purpose and use of assets; and
 - the nature of funding.

Stated objectives

- 14 In many cases the governing legislation, a constitution, a trust deed, or other founding documents will specify the objectives of an entity, including for whom the benefits generated by the entity are intended. For example, the State-Owned Enterprises Act 1986 states that the principal objective of every State enterprise is to "operate as a successful business and to this end, to be:
 - (a) as profitable and efficient as comparable businesses that are not owned by the Crown; and
 - (b) a good employer; and

- (c) an organisation that exhibits a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so.”¹
- 15 The founding documents of an entity may also specify the objective of an entity in terms of the nature of the benefits the entity provides. For example, one of the objectives of District Health Boards is to improve, promote and protect the health of people and communities.
- 16 In the not-for-profit sector, the meaning of charitable purpose is set out in the Charities Act 2005. In that Act, “charitable purpose includes every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community.”²
- 17 Many entities are established with multiple objectives. For example, Crown Research Institutes (CRIs) are required by the Crown Research Institutes Act 1992 (CRI Act) to:
- undertake research for the benefit of New Zealand;
 - comply with any applicable ethical standards;
 - promote and facilitate application of the results of research and technological developments;
 - be a good employer and exhibit a sense of social responsibility; and
 - operate in a financially responsible manner so that they maintain their financial viability.
- 18 Where an entity’s founding documents provide that an entity has multiple objectives, determining the primary objective will depend on an assessment of the substance of the purpose of the entity.
- 19 In assessing the substance of the purpose of the entity where there are multiple objectives, it may be helpful to consider how the entity assesses its performance, as this may indicate which of its stated objectives is its primary objective. For example, if the entity has performance targets for a rate of return on assets or a percentage of return to equity holders, this may indicate the entity is a for-profit entity. However, if the performance targets focus on the level/amount of benefits that have been delivered to achieve a community or social outcome, this may indicate that the entity is a PBE.
- 20 The founding documents may require an entity to be financially viable or to generate an adequate rate of return. However, being financially viable is not in itself conclusive in distinguishing a for-profit entity from a PBE. There is often a community expectation that PBEs will be financially viable and operate to ensure that the limited resources at their disposal are used effectively.

Nature of the benefits, including the quantum of expected financial benefits

- 21 The nature of the benefits provided by an entity including the quantum of the expected financial benefits, may indicate whether an entity is a PBE.
- 22 Unlike for-profit entities, PBEs do not exist to generate a financial surplus in order to provide a financial benefit/return to equity holders. Instead, they exist to provide goods or services for community or social benefit. Hence, if an entity provides goods or services to recipients at no cost or for nominal consideration, the entity is likely to be a PBE. This does not imply that PBEs never generate, or aim to generate, a financial surplus on the net assets employed. However, where a PBE does generate a financial surplus, it may be required or expected to be used to support the entity’s primary objective of providing goods or services for community or social benefit, rather than for providing a financial benefit to equity holders.
- 23 PBEs may establish controlled entities or discrete business units which operate to generate a financial surplus that can be used to support the primary activities of the controlling entity. Such entities or business units may be for-profit. This fact does not affect the classification of the controlling entity or group.³
- 24 The benefits provided by for-profit entities are financial in nature. Most for-profit entities aim to generate a commercial or market return – that is, to maximise the financial benefit/return to equity holders commensurate with the relative risks of operating. Hence, the quantum of the expected financial benefits may indicate whether an entity is a for profit entity or a PBE.

¹ Section 4 State-Owned Enterprises Act 1986

² Section 5(1) Charities Act 2005

³ If a controlled entity or business unit is required to prepare general purpose financial reports its classification is determined by its own primary objective and not that of the controlling entity of the group.

- 25 When considering the quantum of the expected financial benefits and the nature of the benefits provided by an entity, it is important to recognise that the generation of profits and payment of dividends is only one form of financial benefit that can be provided to equity holders. There are many other forms of financial benefit that can be returned to members or equity holders. For example, cooperatives provide a financial benefit to members by paying a rebate based on the volume of transactions with the entity rather than through the payment of dividends. Another example of a financial benefit is the provision of discounted goods and services by an entity to its members.

Primary beneficiaries of the benefits

- 26 An understanding of who the primary beneficiaries of the benefits provided by the entity are (i.e. the people who primarily benefit from the activities of the entity) will assist in determining whether an entity is a PBE.
- 27 Typically, the primary beneficiaries of a for-profit entity are its equity holders (including its parent, where the reporting entity is controlled by another entity)⁴ or other providers of economic resources to the entity (such as debt holders or suppliers). These parties provide economic resources to the entity in exchange for an entitlement to financial returns.
- 28 In contrast, as the primary objective of a PBE is to provide goods or services for community or social benefit, typically the primary beneficiaries of PBEs are members of the community (or a particular section of the community), rather than resource providers.
- 29 If the entity is membership based and the primary beneficiaries of the benefits provided by the entity are not members of the entity, the entity is likely to be a PBE. For example, a heritage trust where membership monies are used for maintaining and enhancing heritage assets for the benefit of the wider community. However, if the primary beneficiaries are members of the entity, it is necessary to consider other factors to determine whether the entity is a PBE (for example, the nature of the benefits and other indicators discussed in this Appendix).

Nature of equity interest

- 30 Where an entity is established to generate a financial return for the benefit of the equity holders the ownership instrument is usually clearly defined. This is important for for-profit entities because it determines the level of financial benefits/returns such as dividends and rights to the residual net assets. If an entity does not have any clear equity holders or the nature of the equity instrument is unclear, the entity is likely to be a PBE.
- 31 The absence of clear equity holders may manifest itself in a number of ways, including:
- the absence of an individual or entity having a right to participate in any financial return or in the net assets of the entity were it to be wound up or otherwise cease to operate; or
 - a requirement that in the event the entity ceases operating any residual net assets are to be applied to another entity with a similar purpose or to revert to another PBE. That is, the use of the assets is effectively restricted to providing goods or services for community or social benefit.

Purpose and use of assets

- 32 The reasons an entity acquires and/or holds an asset may indicate whether it is a PBE. For-profit entities hold assets mainly for sale or for generating a financial benefit for equity holders. The primary reason PBEs (particularly public sector PBEs) hold property, plant and equipment and other assets (including infrastructure assets) is usually for their potential to provide future services for community or social benefit rather than their ability to generate a financial benefit for equity holders. If an entity holds assets primarily for delivering future services for community or social benefit, the entity is likely to be a PBE.
- 33 For example, PBEs may hold assets that contribute to the historical and cultural character of a nation or region, such as art treasures, historical buildings and other artefacts. Other PBEs may be responsible for national parks and other areas of natural significance with native flora and fauna. Such historical items and land are generally not held for sale, even if a market exists. Rather, the respective PBEs have a responsibility to preserve and maintain them for current and future generations.

⁴ As noted in paragraph 12, the assessment of the classification of an entity as a PBE or for-profit entity is made at the reporting entity level. Where the reporting entity is controlled by a PBE, how the PBE parent uses the financial returns provided by the reporting entity to its parent is not relevant to the assessment of whether the reporting entity should be classified as a for-profit entity or PBE.

Nature of funding

- 34 If an entity relies wholly or primarily on donations or other contributions whereby the resource provider does not receive an entitlement to financial returns (or other economic resources) from the entity in return, the entity is likely to be a PBE.
- 35 Many PBEs are dependent on grants and donations. In addition, the sources of funding are usually from third parties (i.e. a source other than the beneficiaries of their services). For example, public sector PBEs receive appropriations and other public funds to carry out their services. Not-for-profit PBEs may rely on government grants, donations from philanthropic organisations and donations and bequests from the public. There may also be restrictions imposed by the provider of the funding on how the funds may be spent.
- 36 PBEs also receive funding through the provision of donated services. For example, many not-for-profit entities rely heavily on volunteers (rather than paid employees) to deliver their services to the community.
- 37 In contrast, for-profit entities are funded primarily by equity holders, debt holders and other suppliers of economic resources, in exchange for an entitlement to dividends, interest and other forms of financial returns (or other economic resources).

Conflicting indicators

- 38 When considering the classification of an entity, in some cases the above indicators may conflict with each other and the primary objective or purpose of the entity may not be obvious. Some indicators may indicate that an entity should be classified as a for-profit entity and others may indicate the entity should be classified as a PBE. In this situation professional judgement is required to evaluate the indicators overall and in combination with each other, including the significance of particular indicators to the overall assessment, to determine whether, in substance, the entity meets the definition of a PBE. For example, if the entity has only a small amount of equity, considering the nature of its equity interest may be less helpful than the other indicators when determining whether, in substance, the entity meets the definition of a PBE.

Changing classification

- 39 Although not expected to be common, changing circumstances may lead to a change in an entity's classification from a PBE to a for-profit entity and vice versa. For example, the constitution of an entity may be amended to change an entity's primary objective from one that is for-profit focused to one that is public benefit focused.
- 40 Accounting for a change in classification depends on the applicable accounting requirements of the new classification. An entity will need to first determine its applicable tier of financial reporting, in accordance with XRB A1. XRB A1 paragraphs 14–30 set out the Tier structure for for-profit entities, and paragraphs 31–72 set out the Tier structure for PBEs. The entity would then need to apply the applicable accounting requirements for its tier of financial reporting, including the requirements on the first-time adoption of that tier of reporting. For example, if an entity's classification changes from a PBE to a for-profit entity, the entity would need to apply NZ IFRS 1 *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards*.

ILLUSTRATIVE EXAMPLES: Determining whether or not an entity is a PBE

- 41 The following examples aim to illustrate application of this Appendix. The examples are illustrative only and do not establish requirements.
- 42 While specific types of entity are referred to in the examples, the circumstances in relation to individual entities may vary significantly, and therefore the examples do not conclude as to whether the entity in question is or is not a PBE. Rather, the examples illustrate indicators to be considered by preparers in reaching a conclusion regarding whether or not an entity is a PBE. In assessing this classification an appropriate weighting needs to be given to each individual indicator. Depending on the circumstances some indicators will provide a stronger indication than others about whether or not an entity should be classified as a PBE. The entity will need to consider each indicator against the other indicators and make an overall assessment of whether or not the entity is a PBE.

Example 1: Crown Research Institute (CRI)

Entity A is a company established under section 11 of the Crown Research Institutes Act 1992 (the CRI Act).

Stated objectives

The CRI Act states that the purpose of every CRI is to undertake research (section 4) and sets out the principles of operation CRIs are expected to follow in fulfilling this purpose. These principles are set out in section 5 of the Act and include, for example, that a CRI should undertake research for the benefit of New Zealand, operate in a financially responsible manner and be a good employer.

The CRI Act establishes a broad framework for the operation of CRIs. The primary objective (purpose) of CRIs is clearly stated in the CRI Act. The principles set out in section 5 are detailed, but they are not ranked and their implementation can be achieved in a number of ways. CRIs, therefore, appear to have discretion as to how they can achieve their purpose.

Nature of the benefits, including the quantum of expected financial benefits

The key benefit of establishing CRIs is the production of research that will benefit New Zealand. In one sense the CRIs undertake research for community or social benefit. The New Zealand economy and entities operating in New Zealand can benefit from the research undertaken.

However, there may be discretion as to how research findings are distributed, in determining the nature of the research to be undertaken and whether the entity intends to generate a financial return for its equity holder (i.e. the Shareholding Minister).

If Entity A distributes the research findings to its customers on a fee-for-service basis with the aim of generating a financial surplus for its equity holder equivalent to a market return, this may indicate that Entity A is a for-profit entity.

If however Entity A undertakes research of a nature that will benefit New Zealand more broadly and makes its research findings available free of charge or for a nominal charge then the benefits provided would be community/social in nature, which may indicate that Entity A is a PBE.

Primary beneficiaries of the benefits

Although Entity A is a company, the primary beneficiaries of the benefits may not necessarily be the Shareholding Minister or the Government.

If the CRI sells its research on a commercial basis for the purpose of providing a financial return to the Shareholding Minister (i.e. the equity holder) then the primary beneficiary would be the entity's equity holder, which may indicate that Entity A is a for-profit entity.

Whereas if the research findings are made available for a nominal fee or free of charge for the benefit of the wider community, such as all entities operating in New Zealand with an interest in those research findings, then the primary beneficiaries would be the wider community, which may indicate that Entity A is a PBE.

Nature of equity interest

Entity A is a company. The equity interest is in the form of shares owned by the Shareholding Minister. In the case of Entity A, the nature of the equity interest is clear. In addition, there is no restriction on the use of assets in the event Entity A is sold, wound up or ceases to operate. This may indicate that Entity A is a for-profit entity.

Conversely, if the company constitution provides that in the event Entity A is wound up, or otherwise ceases to operate, its net assets are required to be transferred to another entity with a similar purpose, this may indicate that Entity A is PBE.

Purpose and use of assets

Entity A owns property, plant and equipment that it uses to undertake research and produce research reports. If Entity A holds those assets to sell or to generate a commercial financial return for the Shareholding Minister, this may indicate that Entity A is a for-profit entity.

However, if the property, plant and equipment is used to undertake research and report on the research findings for the benefit of the New Zealand public then the assets would be held for their potential to provide services to the community, which may indicate that Entity A is a PBE.

Nature of funding

Entity A competes for funding from government and private sources.

If the CRI funds its research activities primarily through charging commercial fees to customers for research services, this may indicate that Entity A is a for-profit entity.

Conversely, if, funding is derived primarily through government grants and donations from private organisations, and there is no requirement to deliver research findings to those funding organisations in return, this may indicate that Entity A is a PBE.

Example 2: Bicycle Shop

A charitable trust is established with the objective of providing health services to the homeless. The Trust receives an annual grant from the Government. The grant is sufficient to cover operating costs necessary to provide basic health care services to a limited number of people. To meet the increasing demand for its services and to fund an expanded range of services, the Trust establishes a bicycle shop (Company 1).

Company 1 sells second hand bicycles and runs a successful bicycle hire service. All surpluses from Company 1 are returned to the Trust to support the primary objective of providing health services to the homeless.

Stated objectives

Company 1's constitution specifies that its objective is to raise funds to support the charitable trust. Therefore, as the entity's stated objective is to generate financial returns for its equity holder, this may indicate that the entity is a for-profit entity.

Conversely, if the entity's stated objective was to provide some form of community or social benefit (e.g. to provide employment for the homeless), this may indicate that the entity is a PBE.

Nature of the benefits, including the quantum of expected financial benefits

Company 1 returns financial surpluses generated through the sale and hire of bicycles to the Trust.

If bicycles are sold and hired at market rates with a view to maximising the financial surplus returned to the Trust, then the nature of the benefits would be financial, which may indicate that the bicycle shop is a for-profit entity.

However, if the shop is used primarily to provide employment to the homeless, and/or the bikes are sold at below market rates or hired out at a nominal/low rate to enable the disadvantaged to benefit from exercise (with any incidental financial surplus returned to the Trust), then the entity would be providing community or social benefits, which may indicate that Company 1 is a PBE.

Primary beneficiaries of the benefits

If bicycles are sold and hired at market rates and the primary beneficiary of the financial surpluses derived is the Trust (i.e. the equity holder), then this may indicate that Company 1 is a for-profit entity.

However, if any financial surplus derived by Company 1 is incidental to employing the homeless and/or providing affordable access to bicycles for the disadvantaged, then this may indicate that Company 1 is a PBE. In this case, the primary beneficiaries of the benefits (employment and bicycle affordability) provided by Company 1 are the homeless and the disadvantaged.

Nature of equity interest

Company 1 is 100% owned and controlled by the Trust. As such the ownership arrangement and equity holder is clear.

If in the event Company 1 ceases trading the trustees are able to determine how to use any residual assets of Company 1, then this may indicate that Company 1 is a for-profit entity.

However, if the trust deed provides that in the event Company 1 ceases trading any residual assets must be donated to a charity that fulfils the same or a very similar charitable purpose to that of the Trust, then this may indicate that Company 1 is a PBE.

Purpose and use of assets

If the directors of Company 1 aim to ensure that the return on the net assets invested in the shop is at least equivalent to a market return, they may recommend that the Trust invest its funds in another activity if a market return is not achieved. This may indicate that Company 1 is a for-profit entity.

However, if Company 1 was operated with the objective of generating a sufficient return on the net assets for it to continue to be a viable organisation, with no reference to a market return on the net assets invested, and instead its assets were used to provide goods or services for community or social benefit (i.e. enabling the disadvantaged to benefit from exercise) this may indicate that Company 1 is a PBE.

Nature of funding

Company 1 funds its activities through the sale and hire of bicycles. The Trust provided a small capital contribution to ensure the shop could purchase bicycles in addition to any that were donated. Company 1 pays a small rental to the Trust. Other outgoings are minimal and there are no borrowings.

If a significant number of the bicycles for hire and for sale were donated by members of the community, this may indicate that Company 1 is a PBE. Similarly, if most of the employees of Company 1 are volunteers, this may indicate that Company 1 is a PBE.

If, however, the funding is derived primarily from the sale and hire of bicycles at normal commercial rates and the Trust expects a return on its investment, this may indicate that Company 1 is a for-profit entity.

Example 3: Private Education Organisation

Entity B is a private organisation dedicated to providing low-cost high-quality education to children who immigrated to New Zealand from poverty-stricken countries. Entity B was established as a Trust with an initial endowment of \$5m from the estate of a wealthy business person.

In order to supplement its income Entity B accepts a limited number of fee-paying students. The fees for such students were determined after market research into the pricing of such services. All fee revenue is applied by Entity B to its objective of providing high-quality education to children who immigrated to New Zealand from poverty-stricken countries. The revenue from fee-paying students has enabled Entity B to expand the range of services it offers and to expand its roll of immigrant children.

The trustees carefully manage the resources of Entity B in order to maximise the number of immigrant children it can accept and to maintain a high-quality educational service. The trustees have a clear operational plan and have established clear financial targets in order to achieve the trust's objectives.

Stated objectives

The trust deed establishing Entity B states that the purpose of Entity B is to provide high-quality education to children who immigrated to New Zealand from poverty-stricken countries.

As Entity B's objective is to provide high-quality education to immigrant children from poverty-stricken countries (i.e. to provide a community or social benefit), this may indicate that Entity B is a PBE.

If the trust deed states that Entity B's purpose is to maximise its financial surplus from fee-paying students while also providing high-quality education to immigrant children, this may indicate that Entity B is a for-profit entity.

Nature of the benefits, including the quantum of expected financial benefits

The nature of the benefits provided by Entity B are the educational services delivered to children from poverty-stricken countries. The equity has been provided to Entity B for the benefit of immigrant children and not for the generation of a financial return for equity holders. The nature of the benefits provided is primarily community/social, which may indicate that Entity B is a PBE.

If the financial targets established by the trustees are expressed in terms of meeting the development targets set out in the operational plan rather than being expressed in terms of a return on equity, this may indicate that Entity B is a PBE.

However, if the financial targets are expressed in terms of a return on equity, this may indicate that Entity B is a for-profit entity.

If Entity B established a subsidiary entity through which it ran its commercial education operations to maximise profits to be paid back to the Trust, then that subsidiary may be a for-profit entity. In this case it would also be necessary to consider whether the group reporting entity is a PBE by considering the characteristics of the controlling entity of the group.

Primary beneficiaries of the benefits

If the objective of Entity B is to provide high-quality education to immigrant children, with any surplus generated used to expand the number of immigrant children who are provided with high-quality education, the primary beneficiaries are the immigrant children. This may indicate that Entity B is a PBE.

If the trust deed identifies specific parties as beneficiaries of the trust (i.e. not the immigrant children) and Entity B limits the amount of surplus used to expand the education programme to immigrant children in order to generate a financial return for the specified beneficiaries, this may indicate that Entity B is a for-profit entity.

Nature of equity interest

Entity B is a trust, so there are no clearly defined ownership instruments.

The trust deed requires that in the event Entity B ceases operating any residual assets are to be distributed to another entity with a similar purpose. The use of the assets is restricted, and there are no clear equity holders that have an entitlement to those assets. This may indicate that Entity B is a PBE.

If the trust deed provides that in the event Entity B ceases operating any residual assets are to be distributed to other specified parties (e.g. the specified beneficiaries), this may indicate that Entity B is a for-profit entity.

Purpose and use of assets

Entity B provides education to both immigrant children and to fee-paying students. The trustees have a clear operational plan and have established clear financial targets to achieve the trust's objectives.

If Entity B uses its assets to provide high-quality education to immigrant children from poverty-stricken countries, rather than to generate a financial return on its equity then this may indicate that Entity B is a PBE.

If the trustees of Entity B require a commercial financial return on those assets, this may indicate that Entity B is a for-profit entity.

Nature of funding

Entity B receives funding from several sources: investment income from the initial endowment, income from fee-paying students, and donations from the public and fundraising activities.

If this funding is derived predominantly from third parties who do not benefit from Entity B's services, and the resource provider does not receive an entitlement to financial returns (or other economic resources), this may indicate that Entity B is a PBE.

If Entity B derives its funding predominantly from fee-paying students and other resource providers in exchange for an entitlement to financial returns (or other economic resources) from the entity, this may indicate that Entity B is a for-profit entity.

Example 4: Sports Club

Club AFC is a football club established in a suburb of a large city. Club AFC organises competitions and provides coaching and training for a wide range of age groups, from five-year-olds through to senior grade, and representative grades.

Stated objectives

Club AFC is established as a charitable trust. Its constitution states that it is a non-profit entity established to foster participation and to promote amateur football in its suburb. This indicates that Club AFC may be a PBE.

If, however, the constitution stated that Club AFC's objective is to maximise profits for the club, then this may indicate that Club AFC is a for-profit entity.

Nature of the benefits, including the quantum of expected financial benefits

The benefits provided by Club AFC arise from the coordination of football competitions and the provision of football coaching and training to club members. This may indicate that Club AFC is a PBE.

If Club AFC were to sell a significant amount of its coaching, and training services (e.g. to schools, other football clubs, or individuals) at normal market rates, with the aim of generating financial returns for its members this may indicate that Club AFC is a for-profit entity.

If Club AFC uses the surpluses from selling its services to ensure the Club remains financially viable with any surplus used to develop the services it offers to club members and the wider amateur football community, this may indicate that Club AFC is a PBE.

If the financial targets are set with the objective of generating a commercial rate of return for its members, this may indicate that Club AFC is a for-profit entity.

Primary beneficiaries of the benefits

Club AFC provides training and coaching for all age groups and grades of players who are members of the club. The Club also organises football competitions in which other amateur football clubs participate.

If the Club's activities primarily benefit the wider community (for example, by promoting soccer as part of a keeping active programme, providing some coaching at no cost for schools or providing free soccer memberships for disadvantaged children in the community), this may indicate that Club AFC is a PBE.

If, however, the primary beneficiaries of the Club's activities are the members of Club AFC, it is necessary to consider other factors (for example, the nature of the benefits and other indicators discussed in this Appendix) to determine whether the entity is a PBE.

Nature of equity interest

Club AFC is a member-based entity and there are no clear equity holders. This may indicate that the Club is a PBE. If, however, the Club was owned by shareholders expecting a financial return on their investment in the Club, this may indicate that the Club is a for-profit entity.

If the constitution states that in the event the Club is wound up or ceases operating, any residual assets are to be applied to an organisation with a similar purpose as Club AFC, this may indicate that the Club is a PBE.

However, if the constitution states that in the event the Club is wound up or ceases to operate any residual assets are to be distributed to the members, this may indicate that the Club is a for-profit entity.

Purpose and use of assets

Club AFC's assets comprise primarily football equipment (nets, balls, uniforms etc), as well as tripods and filming technology used to analyse matches for the purpose of coaching and training. A small shed is leased at the local community centre to store the equipment.

If the Club's assets are used primarily to provide coaching, training and competitions for amateur players in the community, then this may indicate that Club AFC is a PBE.

However, if Club AFC sells a significant amount of its coaching and training services and charges commercial market rates to other individuals or entities for using its tripods and filming technology, then its assets may be generating a financial return for its members. This may indicate that the Club is a for-profit entity.

Nature of funding

Club AFC receives funding from membership fees, donations, sponsorship and community grants.

If this funding does not establish a financial interest in the Club, this may indicate that Club AFC is a PBE.

If Club AFC receives funding primarily from members and other resource providers who are expecting either a financial return on their investment or other economic resources in return for providing funds, this may indicate that Club AFC is a for-profit entity.

Example 5: Social Enterprise

The social enterprise model is becoming a more prevalent way for entities to operate. It is important to note that an entity that identifies itself as a social enterprise may not necessarily be a PBE. It is possible for an entity that identifies itself as a social enterprise to be a for-profit entity that also has a social objective.

Entity C is a company which donates one lunch for a hungry school child at a low decile school for every lunch that it sells to the public, that is, the cost of the donated lunch is built into the cost of the lunch that is sold.

Stated objectives

Entity C's constitution states that its objective is to provide healthy food, including lunches, to patrons and to children at low decile schools.

If Entity C's constitution states that its objective is to help children at low decile schools by providing healthy lunches, this may indicate that Entity C is a PBE.

If Entity C's objective is to maximise profits while also achieving a social objective of providing healthy lunches to children at low decile schools, this may indicate that Entity C is a for-profit entity.

Nature of the benefits, including the quantum of expected financial benefits

If Entity C generates substantial surpluses, after covering the costs of free lunches, with those surpluses distributed to its shareholders or retained for additional business investments, the nature of the benefits provided are primarily financial. This may indicate that Entity C is a for-profit entity.

If Entity C uses the surpluses from the sale of lunches primarily to fund the costs of the free lunches and other operating costs, with any surplus used to expand the number of free lunches provided to school children, the nature of the benefits provided are primarily community/social. This may indicate that Entity C is a PBE.

Primary beneficiaries of the benefits

Entity C has three shareholders.

If Entity C limits the amount of its surplus from the sale of lunches that can be used to provide free lunches, to ensure that it generates an adequate financial return for its shareholders, the primary beneficiaries are the shareholders, which may indicate that Entity C is a for-profit entity.

Conversely, if Entity C uses most of the surpluses from the sale of lunches to provide free lunches to children in low decile schools rather than distributing the profits to its shareholders, the primary beneficiaries are the children at low decile schools. This may indicate that Entity C is a PBE.

Nature of the equity interest

Entity C has two founding shareholders. To enable expansion plans to be completed, additional shares were issued to a shareholder who has a prominent business in the food distribution sector. The equity holders are clearly identifiable by the equity instruments they hold.

If:

- (a) there were no entitlements to dividends;
- (b) all profits were reinvested in Entity C; and
- (c) on Entity C ceasing to operate, any residual assets were to be donated to an entity with a similar charitable objective,

this may indicate that Entity C is a PBE.

If Entity C's shareholders have an entitlement to dividends and to a share of the residual net assets of the entity if it is wound up, this may indicate that Entity C is a for-profit entity.

Purpose and use of assets

Entity C acquires or holds its assets to provide healthy lunches for children in low decile schools and to make lunches and healthy food that are sold to the public.

If the assets are used primarily to provide healthy lunches for children in low decile schools, this may indicate that Entity C is a PBE.

If Entity C acquires or holds its assets primarily to sell or to generate financial benefits for its equity holders, this may indicate that Entity C is a for-profit entity.

Nature of Funding

Entity C's equity was initially provided by shareholders.

If Entity C relies primarily on donations and grants from the general public and funding organisations, and has a predominantly volunteer workforce, this may indicate that Entity C is a PBE.

If Entity C's funding is provided primarily by shareholders and other resource providers in exchange for an entitlement to financial returns (e.g. dividends) or other economic resources, this may indicate that Entity C is a for-profit entity.

Paragraphs BC43–BC45 and the related heading are added.

BASIS FOR CONCLUSIONS ON STANDARD XRB A1 APPLICATION OF THE ACCOUNTING STANDARDS FRAMEWORK

This Basis for Conclusions accompanies, but is not part of, XRB A1 Application of the Accounting Standards Framework.

...

2019 Amendments to XRB A1

- BC43. Appendix A of XRB A1 provides guidance to assist an entity to determine whether it is a public benefit entity (PBE) or a for-profit entity for the purpose of complying with standards issued by the External Reporting Board. In December 2018 the XRB issued Exposure Draft *2018 Amendments to XRB A1 Appendix A* which proposed changes to Appendix A. The XRB noted that some of the guidance in Appendix A was based on guidance that existed prior to the New Zealand Accounting Standards Framework being issued and considered that, now the Framework had been operational for some time, it was appropriate to review the guidance in Appendix A. In addition, the XRB had received feedback that some constituents had experienced difficulties applying Appendix A.
- BC44. The proposals included:
- (a) clarifications to the guidance on the definition of a PBE. For example, the proposed amendments clarified that both parts of the definition of a PBE need to be assessed in combination when determining an entity's classification;
 - (b) two new indicators, being (i) primary beneficiaries of the benefits; and (ii) purpose and use of assets;
 - (c) the merging of the indicators dealing with (i) nature of the benefits and (ii) the quantum of the expected financial surplus;
 - (d) the illustrative examples were revised and a new illustrative example was added.
- BC45. Respondents were broadly supportive of the proposals. The XRB agreed to proceed with the proposals and issued *2019 Amendments to XRB A1 Appendix A* in May 2019.

Part D: Effective date

This Standard is effective for periods beginning on or after 1 January 2020, with earlier application permitted.

28 March 2019

Mr Warren Allen
The Chief Executive
External Reporting Board
PO Box 11250
Manners St Central
Wellington
6142

Dear Sir

Requests to comment on Exposure Draft 2018 Amendments to XRB A1 Appendix A

Thank you for the opportunity to comment on the above Exposure Draft.

We are making this submission to you to assist the New Zealand External Reporting Board (XRB) with the above Exposure Draft. We are happy for you to publish our comments publicly.

In responding we have addressed the specific questions for respondents in Appendix 1.

Overall we are supportive of the proposals contained in the Exposure Draft.

More information on BDO is provided in Appendix 2 to this letter.

We hope that our responses and comments are helpful. Should you wish to discuss any of the points we have raised please contact me (michael.rondel@bdo.co.nz) should you have any queries or require further information.

Yours faithfully,



BDO New Zealand
Michael Rondel
Audit Technical Director

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Natalie Tyndall
Head of Financial Reporting

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Appendix 1 - Response to questions

Question	Response
Question 1 Do you agree with the proposed amendments to XRB A1 Appendix A When is an Entity a Public Benefit Entity? If you disagree, please provide reasons.	Yes, we agree with the proposed amendments.
Question 2 Do you agree with the proposed effective date of 1 January 2020? If you disagree, please provide reasons.	Yes, we agree with the proposed effective date of 1 January 2020.
Question 3 Do you have any other comments on the ED?	We have no further comments on the ED.

Appendix 2 - Information on BDO

1. BDO New Zealand is a network of ten independently owned accounting practices, with fifteen offices located throughout New Zealand.
2. BDO firms in New Zealand offer a full range of accountancy services, including business advisory, audit, taxation, risk advisory, internal audit, corporate finance, forensic accounting and business recovery and insolvency.
3. BDO in New Zealand has 84 partners and over 800 staff.
4. BDO firms throughout New Zealand have a significant number of clients in the not-for-profit sector.
5. Five BDO firms in New Zealand (BDO Auckland, BDO Christchurch, BDO Northland, and BDO Wellington) are registered audit firms and thirteen audit partners are licensed auditors.
6. Internationally, BDO is the fifth largest full-service audit, tax and advisory firm in the world, with over 73,800 people in over 1,500 offices across over 162 countries and territories.



29 March 2019

Warren Allen
Chief Executive
External Reporting Board
PO Box 11250
Manners St Central
Wellington 6142

Email: submissions@xrb.govt.nz

Dear Warren

EXPOSURE DRAFT 2018 AMENDMENTS TO XRB A1 APPENDIX A

We appreciate the opportunity to comment on the Exposure Draft *2018 Amendments to XRB A1 Appendix A*.

In our view, it is important to have the right guidance to help entities determine the accounting standards they should use to prepare their financial statements. We acknowledge that guidance will not eliminate the need for judgement to be applied to the circumstances of particular entities.

Overall, we are of the view that the amendments are an improvement to XRB A1 Appendix A. In particular, it is useful to have introduced an indicator regarding the purpose and use of assets.

We comment on a few matters below where we think further clarity could be provided.

The term “equity holders” does not easily fit all situations

The purpose and use of assets (paragraph 32) notes that the reason an entity acquires and/or holds an asset may indicate whether it is a public benefit entity. This paragraph further elaborates that for-profit entities hold assets mainly for sale or for generating a financial benefit for equity holders.

However, there are non-company structures such as trusts which do not have “equity holders”, in a traditional sense, and where financial benefits are being generated.

For example, licensing trusts operate in a commercial manner to maximise financial returns. However, they are community organisations in the sense that any surplus profits must be used for community or philanthropic purposes.

We recommend that the paragraphs regarding purpose and use of assets could be enhanced by clearly explaining what is meant by the term “equity holders” in non-company structures, or using terminology that can apply across different types of entity in the public sector.

The quantum of expected financial surplus is a strong indicator

The current version of XRB A1 – paragraph 11 of Appendix A includes the indicator “*the quantum of expected financial surplus*.” This has been combined with the indicator “*Nature of the benefits*” in the updated appendix.

Some of the text of the previous *quantum of expected financial surplus* indicator (which is now part of the nature of the benefits) has been deleted – namely the sentence in paragraph 20 “The quantum of the expected surplus will provide a strong indication whether an entity is a PBE.”

From our perspective, this sentence has proved to be both relevant and useful. We have found it helpful when considering judgement calls about whether an entity is a public benefit entity.

We recommend that the updated appendix include discussion that the quantum of the expected financial benefits will usually provide a strong indication whether an entity is PBE.

A change in classification could be a for-profit entity becoming a public benefit entity

Paragraph 40 includes an example of an entity’s classification changing from a public benefit entity to a for-profit entity. We recommend that paragraph 40 also include an example of a for-profit entity becoming a public benefit entity. For example, if a Tier 1 or 2 for-profit entity becomes a Tier 1 or Tier 2 public benefit entity, the entity would need to apply PBE FRS-46 *First-time Adoption of PBE Standards by Entities Previously Applying NZ IFRS*.

The reasons for the changes to XRB A1 Appendix A should be explained

We note that the proposed amended XRB A1 Appendix A does not include a basis for conclusions. We think it is important to explain the reason for significant changes to XRB A1 Appendix A, and in particular the inclusion of the indicator regarding the purpose and use of assets.

Purpose and use of assets indicator

The purpose and use of assets is an important indicator because applying existing indicators has led to judgements about entities not being considered public benefit entities, which has resulted in illogical asset accounting. An example of illogical accounting of assets is the situation where an entity reports using for-profit accounting standards and each year acquires and capitalises assets only to impair (or write-off) the assets because the cash flows from the assets do not support their cost.

We recommend the purpose and use of asset indicator include discussion that if an entity’s primary objective is to operate an asset, such as infrastructure, and any new investment in that asset is not supported by future cash flows generated from the asset, this provides a strong indication an entity is a PBE.

If you have any questions about our submission, please phone Sara Moonlight, Director, Accounting Policy on +64 21 244 0545 or email her at Sara.Moonlight@oag.govt.nz.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Todd Beardsworth', with a long horizontal flourish extending to the right.

Todd Beardsworth

Assistant Auditor-General, Accounting and Auditing Policy

22 March 2019

Mr Warren Allen
Chief Executive
External Reporting Board
PO Box 11250
Manners St Central
Wellington 6142

Dear Warren

Auckland Council submission to NZASB ED 2018 Amendments to XRB A1 Appendix A

Thank you for the opportunity to comment on the exposure draft 2018 Amendments to XRB A1 Appendix A.

Auckland Council is Australasia's largest local government entity and is made up of the Council and six substantive council-controlled organisations. We invest heavily in infrastructure and many of our decisions will have a fiscal impact on Auckland's future generations. Auckland Council encompasses both for-profit and public benefit entities within the group. This exposure draft is relevant to the classification of the entities within the Auckland Council Group and therefore we have reviewed the proposed updates and provided our feedback.

Our responses to the specific questions for the respondents are included in Appendix 1 to this letter along with our additional comments for the XRB's consideration. In summary we are supportive of the proposed amendments to XRB A1 Appendix A.

We hope our responses and comments are helpful in aiding your decision-making process. Should you have any queries relating to the responses, please do not hesitate to contact Alvin Ang at the details provided below.

Yours sincerely



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Tsu Chun Ang (Alvin)
Senior Group Reporting Technical Accountant

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alvin.ang@aucklandcouncil.govt.nz

Appendix 1 – Response to questions

We are generally supportive of the proposed amendments made in the exposure draft.

1. Do you agree with the proposed amendments to XRB A1 Appendix A *When is an Entity a Public Benefit Entity?* (para 9 – 24) If you disagree, please provide reasons.

We agree with the proposed amendments to XRB A1 Appendix A. The amendments provide greater clarity on guidance for existing indicators and include additional indicators, which will benefit entities in assessing their status as a Public Benefit Entity (PBE).

The impact on Auckland Council Group would be to reassess all entities within the group for PBE classification, but we do not expect any changes to classification for these entities.

2. Do you agree with the proposed effective date of 1 January 2020? (para 25) If you disagree, please provide reasons.

We agree with the proposed effective date of 1 January 2020, as this will provide guidance earlier to preparers to address issues in applying Appendix A. We do not expect the proposed amendments to materially impact the classification of existing entities as PBE or for-profit.

3. Do you have any other comments on the ED?

We have no further comments.

28 March 2019

Warren Allen
Chief Executive
External Reporting Board
P O Box 11250
Manners St Central
Wellington 6142

Dear Warren

Submission on 2018 Amendments to XRB A1 Appendix A

Thank you for the opportunity to make a submission on the above Amendments. These should help clarify the understanding of entity type for financial reporting purposes.

I have answered the questions below:

1. Do you agree with the proposed amendments to XRB A1 Appendix A *When is an Entity a Public Benefit Entity?*

Yes, the increased range of indicators should be helpful for entities to ascertain whether they are a PBE or for-profit entity.

However, I note that in most of the sections (para 24, 29, 32, 34 and in respect of multiple objectives in para 19), there is a statement that an entity is 'likely to be a PBE'. Yet, paras 14-16 no such statements are provided. If they were, it would provide a purpose for these examples.

2. Do you agree with the proposed effective date of 1 January 2020?

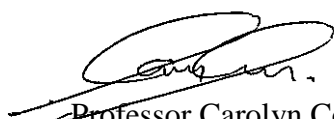
Yes, or earlier adoption as noted in the ED.

3. Do you have any other comments on the ED?

No.

I trust these are helpful in finalising the changes.

Yours sincerely,



Professor Carolyn Cordery,
Aston Business School

XRB ED 2018 Amendments to XRB A1 Appendix A

Comments from Respondent 5

Thank you for the opportunity to comment on the **2018 Amendments to XRB A1 Appendix A – *When is an Entity a Public Benefit Entity?***.

We appreciate the ability to provide feedback in either a formal or informal manner and believe this is an effective means to facilitate responses, particularly where there are no strong changes proposed in our response.

We support the Exposure Draft and the effective date of 1 January 2020, with earlier application permitted. Furthermore we support:

- the inclusion of more guidance on the definition of a PBE;
- the identification of indicators that an entity considers in determining whether it is a PBE or for-profit entity; and
- the revised illustrative examples.

Proposed amendments:

- In the new illustrative example, we consider it useful to consider both parts of the test (primary objective and provision of equity) rather than just the indicators.
- Furthermore, we would appreciate further guidance in the Appendix on assessing whether a consolidated Group is a PBE. i.e. whether the ultimate controlling entity and consolidated reporting entity is a PBE. This may be helpful for examples where charitable trusts control the main operating for-profit entity or where you have a mix of reporting entities consolidated into the Group.

XRB ED 2018 Amendments to XRB A1 Appendix A

Comments from Respondent 6

If possible, it would be good if the guidance could be clearer around shareholder equity interests, as we have charitable companies within charitable groups, and when there are reporting obligations by those companies (for various reasons).

Does an equity interest in shares that provide a return prohibit PBE classification absolutely?

The proposals clarify that both limbs must be met; as such with the second limb - *“(ii) the provision of any equity is to support that primary objective rather than for a financial return to equity holders”* – could be read to suggest that any equity **that provides any level of return** might prevent a PBE classification.

- Is this the intention, or is judgement able to be applied to the substance – perhaps with a nature/scale override?

Scale of equity – vs level of return provided by equity

There is now a reference to the scale of equity in the guidance – but **perhaps scale of equity return is more relevant?** As whether the share capital is \$100 or \$1,000,000 doesn't really indicate the nature.

(This is relative to the in the text within para 38: *For example, if the entity has only a small amount of equity, considering the nature of its equity interest may be less helpful than the other indicators when determining whether, in substance, the entity meets the definition of a PBE. [based on paragraph 27])*

- Would a more relevant consideration perhaps be whether the level of return provided by the equity is what an arms-length commercial investor would seek?



EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

DATE: 18 April 2019
TO: Members of the External Reporting Board
FROM: Judith Pinny
SUBJECT: Review of Charities Act 2005

Recommendations

1. It is recommended that the Board
 - (a) **NOTE** the Discussion Document Modernising the Charities Act 2005; and
 - (b) **CONSIDER** and **PROVIDE FEEDBACK** on the draft comment letter from the XRB Board.
 - (c) **APPROVE** the comment letter, subject to any suggested changes.

Introduction

2. The review of the Charities Act 2005 (the Act) was announced by the Government in May 2018. The aim of the review is to ensure that the Act is effective and fit-for-purpose, with sufficient flexibility to suit the needs of diverse charities. It is being conducted by the Policy Division of the Department of Internal Affairs (DIA) which is separate from Charities Services (which is also part of DIA).
3. The DIA released the Discussion Document Modernising the Charities Act 2005 (Discussion Document) on 25 February 2019 (Agenda item 2.11.2).
4. Submissions were originally timetabled to close on 30 April 2019. However, on 11 April, Minister Henare announced an extension for submissions to 31 May 2019.
5. Although it is not customary for public sector entities to make formal submissions on consultation documents issued by other public sector entities, the XRB has been specifically asked by DIA to make a submission on the review of the Charities Act.
6. The comment letter covers four questions from the Discussion Document which are particularly relevant to the setting of accounting standards for registered charities.

Background

7. The initial draft of this submission was provided to the NZASB at their meeting on 20 March 2019. The NZASB's comments were then incorporated in the next draft. We also incorporated further data from the Charities Register and Discussion Document which enabled the development of Tables 1 to 4.

8. The NZAuASB asked to see the latest draft at their meeting on 10 April 2019. They were provided with both hard and electronic copies. Four Board members provided comprehensive comments. Two further Board members advised they had read it and had no further comments.
9. The current draft (agenda item 2.11.4) incorporates the NZAuASB's comments.

Next steps

The comment letter is now due on 31 May 2019.

- (a) Amend the draft submission for comments received at this meeting. If changes are minimal, the XRB Board may ask the Chair of the XRB Board to finalise.
- (b) The final submission will be signed by the Chair of the XRB Board and forwarded to the Charities Act Review Policy Team.

Attachments

Agenda item 2.11.2: *Modernising the Charities Act 2005 Quick Read*

Agenda item 2.11.3: *Modernising the Charities Act 2005 Discussion Document*

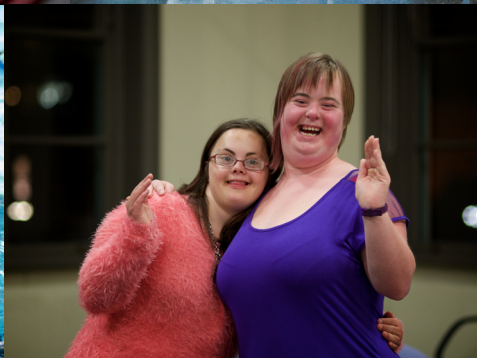
Agenda item 2.11.4: Draft submission on the Review of the Charities Act 2005



Modernising the Charities Act 2005

Quick read

February 2019



Modernising the Charities Act 2005

This quick read explains how to have your say on modernising the Charities Act 2005 (the Act), the reasons for modernising, and key issues we want your feedback on.

Your submission is crucial to help the Government consider how to improve the Act.

How to have your say

View the full discussion document and find out how to have your say at www.dia.govt.nz/charitiesact.

Submissions close on **30 April 2019**. You can submit by email or post.

Why modernise the Act, and what do we want to achieve?

The Act provides a registration, reporting and monitoring system for charities.

Modernising the Act is about ensuring the Act is fit for purpose and suits the different needs of New Zealand's diverse charities.

A well-designed and effective Act will contribute to a thriving and sustainable charities sector where:

- New Zealanders understand, trust, and have confidence in charities;
- charities have the capability and capacity to effectively deliver on their charitable purposes, and New Zealanders benefit as a result; and
- the expertise and independent voice of charities helps inform the policies and services that affect the communities they work with.

Find out more on pages 13 to 16 of the discussion document.

Selection of key issues

Current and future focus: what's needed for the Act to work for a diverse sector?

More than 27,000 registered charities contribute

enormously to our communities. Many provide education, social services or religious services, while others make grants, maintain marae, provide communities facilities, or carry out other diverse activities.

Charities in New Zealand spend around \$17 billion annually, manage \$58 billion in total assets, and are supported by more than 230,000 volunteers and 180,000 paid staff.

Registration provides exemptions from income tax. Some small charities receive little or no tax benefits from registration, but other non-tax benefits can be important (such as public recognition that donating to a charity benefits the community).

We want to hear:

- Why did your organisation register as a charity?
- What benefits does your charity experience from being registered under the Act?
- What are the key challenges and opportunities facing the charities sector over the next ten years?

Find out more on pages 16 to 18 of the discussion document.

Obligations: are current requirements for remaining on the register working?

Charities' obligations need to be clear and manageable for charities but also strong enough to ensure the public have trust and confidence in the sector.

All charities must maintain their charitable purposes, file an annual return, and tell the regulator if they change their key personnel or rules.

Some charities accumulate considerable funds (or other assets) over many years. There are often good reasons for this, like managing and growing a charity's assets for current and future generations. In other cases, a charity may accumulate funds over many years with no clear rationale.

We want to know:

- Is more support required for charities to meet their obligations?

- Should charities be required to be more transparent about their strategy for accumulating funds and spending funds on charitable purposes?

Find out more on pages 18 to 24 of the discussion document.

Regulator: does the regulator have the right functions and powers?

The regulator's role, functions, and powers under the Act are important because they enable it to promote public trust and confidence in the charities sector and to encourage the effective use of charitable resources.

The regulator comprises two bodies: the Charities Registration Board (Board) made up of three members, and Charities Services (within the Department of Internal Affairs). The Board makes decisions to register or deregister charities. Charities Services gives educational support and advice to charities, maintains the charities register, and monitors and promotes compliance. Charities Services also makes decisions to register or deregister charities under delegation from the Board.

We are interested in better understanding concerns that current arrangements may not ensure independent decision-making. Independent registration decisions are crucial to the system's integrity.

We want your views on matters such as:

- How could the regulator be made more accessible to charities?
- What is driving concerns over the independence of decision-making by the regulator?

Find out more on pages 25 to 33 of the discussion document.

Appeals: how can the process to appeal decisions be improved?

The ability to appeal registration decisions is important to help develop charities law and hold decision-makers to account.

Currently, a person can appeal a decision of the Board to the High Court (including decisions that Charities Services makes under delegation from the Board). High Court appeals can be costly, and few appeals are made each year.

An ongoing sector concern is that any decision made under the Act – not just registration and deregistration decisions – should be subject to appeal.

We seek your views on how the appeal process is working, and how to improve it, including:

- Which decisions made by Charities Services should be subject to appeal? Why?
- What body is most appropriate to hear appeals?

Find out more on pages 34 to 37 of the discussion document.

Te Ao Māori: how can the Act work better for Māori charities and Māori communities?

The Act should help to support the aspirations of Māori communities and enable the Crown to fulfil its obligations as a Treaty partner.

Māori charities are a diverse and significant part of the charities sector, providing benefits to Māori and the wider public. Māori charities range from large iwi settlement organisations to small rural marae.

We want your views on what is working for Māori under the Act and what is not, including:

- Are there any issues under the Act that impact Māori charities differently to other charities?
- Are you aware of any cases where an iwi settlement organisation has limited its activity because of its charitable status?
- Are you aware of any problems with the reporting requirements for Māori charities?

Find out more on pages 38 to 40 of the discussion document.

Business: how can the risks of charities operating businesses to raise funds be managed?

Businesses can be an important income source for charities. Businesses can also put charitable funds at

risk because the charity may not get back the money used to support the business.

Charities may run ‘unrelated businesses’, where the service or product does not directly contribute to a charitable purpose (e.g. food and drink retailers, hotels). The test is whether income from those business activities is ultimately applied to charitable purposes.

The Act should enable charities to raise funds to support their work, while providing certainty that charities are only undertaking business activities to further charitable purposes and no individual is profiting.

We want to hear your views on:

- What should be the registration requirements for ‘unrelated businesses’?
- How should charities report on their business operations and business subsidiaries?

Find out more on pages 41 to 45 of the discussion document.

Advocacy: should there be limits on advocacy by charities?

‘Advocacy’ is about working to change, or stop changes, to law and government policy. It also includes promoting points of view on issues in society.

Advocacy can be a legitimate and important way for charities to achieve their charitable purposes. However, there is a lack of clarity on when charities can engage in advocacy.

We want to hear your views on:

- Would you like to see greater freedom for charities to advocate for policy or law change? What would be the benefits? What would be the risks?
- Should there be limits on advocacy by charities? If so, what should these be?

Find out more on pages 46 to 50 of the discussion document.

What is not within scope?

This modernisation work is not looking at the following matters:

- the definition of ‘charitable purpose’ (section 5(1) of the Act), which will continue to be based on court judgments;
- tax exemptions for charities registered under the Act;
- regulation of the broader not-for-profit sector; and
- contracting arrangements for government services.

What happens next?

Attend a community meeting

The Department of Internal Affairs will be hosting 21 community meetings throughout the country between 6 March and 18 April 2019 about modernising the Charities Act. Attend a community meeting to hear about the modernisation work and discuss it with the Department and charities sector representatives. Register to attend a community meeting in your area at www.dia.govt.nz/charitiesact.

Make a written submission

To have your say, make a written submission by 30 April 2019. Download a submission form from www.dia.govt.nz/charitiesact.

Your submission will inform policy development and government decisions. If Cabinet agrees, a new law (a Bill) will be introduced to Parliament later in 2019, and a Select Committee will invite public comment. You will then have the opportunity to have your say on specific proposals.

If you have any questions or want more information about the modernisation work or submissions process, please visit www.dia.govt.nz/charitiesact or email charitiesact@dia.govt.nz.



Modernising the Charities Act 2005

Discussion document

February 2019



Foreword



Tēnā koutou katoa

Charities play a vital role in supporting people and communities throughout New Zealand.

More than 27,000 registered charities assist Kiwis in diverse areas including the arts, community development, education, emergency services, environment, health, housing, marae, religion, social services, and sport. These charities are supported by more than 230,000 volunteers and 180,000 paid staff.

Now is the opportunity to take stock of how the Charities Act 2005 is operating, and how the world has changed since the Act came into force. It is a chance to explore how the Act could better enable charities to have a positive impact on their communities. Modernising the Act is my top priority as Minister for the Community and Voluntary Sector.

An Act that is working well for charities, the regulator, and the public will help ensure that the charities sector is as effective as possible and enjoys the trust and confidence of the public.

This discussion document seeks your feedback on how the Act is working at present and what could be improved. I urge everyone with an interest in the work of charities to get involved and have their say. Your views and feedback during this process are essential to ensuring the best outcomes for communities around New Zealand.

Ngā mihi

A handwritten signature in dark ink, appearing to read 'P. Henare'.

Hon Peeni Henare
Minister for the Community and Voluntary Sector

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Executive summary

This summary explains how to have your say on modernising the Charities Act 2005 (the Act), the reasons for modernising, and key issues we want your feedback on.

Your submission is crucial to help the Government consider how to improve the Act.

How to have your say

Submissions close on 30 April 2019. You can submit by email or post.

The Appendix at page 51 lists all of the questions contained in this document by topic. You can answer as many, or as few, questions as you like in your submission.

A downloadable submission form is available at www.dia.govt.nz/charitiesact.

Find out more on page 8 of this document.

Why modernise the Act, and what do we want to achieve?

The Act provides a registration, reporting and monitoring system for charities.

Modernising the Act is about ensuring the Act is fit for purpose and suits the different needs of New Zealand's diverse charities sector.

A well-designed and effective Act will contribute to a thriving and sustainable charities sector where:

- New Zealanders understand, trust, and have confidence in charities;
- charities have the capability and capacity to effectively deliver on their charitable purposes, and New Zealanders benefit as a result; and
- the expertise and independent voice of charities helps inform the policies and services that affect the communities they work with.

Find out more on pages 13 to 16 of this document.

Key issues

Current and future focus: what's needed for the Act to work for a diverse sector?

More than 27,000 registered charities contribute enormously to our communities. Many provide education, counselling or religious services, while others make grants, maintain marae, provide communities facilities, or carry out other diverse activities.

Charities in New Zealand spend around \$17 billion annually, manage \$58 billion in total assets, and are supported by more than 230,000 volunteers and 180,000 paid staff.

Registration provides exemptions from income tax. Some small charities receive little or no tax benefits from registration, but other non-tax benefits can be important (such as public recognition that donating to a charity benefits the community).

We want to hear:

- Why did your organisation register as a charity?
- What benefits does your charity experience from being registered under the Act?
- What are the key challenges and opportunities facing the charities sector over the next ten years?

Find out more on pages 16 to 18 of this document.

Obligations: are current requirements for remaining on the register working?

Charities' obligations need to be clear and manageable but also strong enough to ensure the public have trust and confidence in the sector.

All charities must maintain their charitable purposes, file an annual return, and tell the regulator if they change their key personnel or rules.

Some charities may accumulate considerable funds (or other assets) over many years. There may be good reasons for this, like managing and growing a charity's assets for current and future generations. In other cases, a charity may accumulate funds over many years with no clear rationale.

We want to know:

- Is more support required for charities to meet their obligations? If so, what type of support is needed?
- Should charities be required to be more transparent about their strategy for accumulating funds and spending funds on charitable purposes?

Find out more on pages 18 to 24 of this document.

Regulator: does the regulator have the right functions and powers?

The regulator comprises two bodies: the Charities Registration Board (the Board) made up of three members, and Charities Services (a business group within the Department of Internal Affairs).

The Board makes decisions to register or deregister charities. Charities Services gives educational support and advice to charities, maintains the charities register, and monitors and promotes compliance. Charities Services also makes decisions to register or deregister charities under delegation from the Board.

We are interested in better understanding a perception that current arrangements may not ensure independent decision-making. Independent registration decisions are crucial to the system's integrity.

We want your views on matters such as:

- How could the regulator be made more accessible to charities? For example, what would consultation requirements or an advisory board achieve?
- What is driving concerns over the independence of decision-making by the regulator?

Find out more on pages 25 to 33 of this document.

Appeals: how can the process to appeal decisions be improved?

The ability to appeal registration decisions is important to help develop charities law and hold decision-makers to account.

Currently, a person can appeal to the High Court from a Board decision (including decisions that Charities Services makes under delegation from the Board). High Court appeals can be costly, and few appeals are made each year.

An ongoing sector concern is that any decision made under the Act – not just registration and deregistration decisions – should be subject to appeal.

We seek your views on how the appeal process is working, and how to improve it, including:

- Which decisions made by Charities Services should be subject to appeal? Why?
- What body is most appropriate to hear appeals?

Find out more on pages 34 to 37 of this document.

Te Ao Māori: how can the Act work better for Māori charities and Māori communities?

The Act should help to support the aspirations of Māori communities and enable the Crown to fulfil its obligations as a Treaty partner.

Māori charities are a diverse and significant part of the charities sector providing benefits to Māori and the wider public. Māori charities range from large iwi settlement organisations to small rural marae.

We want your views on what is working for Māori under the Act and what is not, including:

- Are there any issues under the Act that impact Māori charities differently to other charities?
- Does charitable status limit the activities of iwi settlement organisations?
- Are there particular problems with reporting for Māori charities?

Find out more on pages 38 to 40 of this document.

Business: how can the risks of charities operating businesses to raise funds be managed?

Businesses can be an important income source for charities. Businesses can also put charitable funds at risk because the charity may not get back the money used to support the business.

Charities may run 'unrelated businesses', where the service or product does not directly contribute to a charitable purpose (e.g. food and drink retailers, hotels). The test is whether income from those business activities is ultimately applied to charitable purposes.

The Act should enable charities to raise funds to support their work, while providing certainty that charities are only undertaking business activities to further charitable purposes and no individual is profiting.

We want to hear your views on:

- What should be the registration requirements for 'unrelated businesses'?
- How should charities report on their business operations and business subsidiaries?

Find out more on pages 41 to 45 of this document.

Advocacy: should there be limits on advocacy by charities?

'Advocacy' is about working to change, or stop changes, to law and government policy. It also includes promoting points of view on issues in society.

Advocacy can be a legitimate and important way for charities to achieve their charitable purposes. However, there is a lack of clarity on when charities can engage in advocacy.

We want to hear your views on:

- Should there be limits on advocacy by charities?
- Would you like to see greater freedom for charities to advocate for policy or law change? What would be the benefits? What would be the risks?

Find out more on pages 46 to 50 of this document.

What is not within scope?

This modernisation work is not looking at the following matters:

- operational matters;
- the definition of 'charitable purpose', (section 5(1) of the Act), which will continue to be based on court judgments;
- tax exemptions for charities registered under the Act;
- regulation of the broader not-for-profit sector; and
- contracting arrangements for government services.

What happens next?

Attend a community meeting

The Department of Internal Affairs will be hosting 21 community meetings throughout the country between 6 March and 18 April 2019 about modernising the Charities Act. Attend a community meeting to hear about the modernisation work and discuss it with the Department and charities sector representatives.

Register to attend a community meeting in your area at www.dia.govt.nz/charitiesact.

Make a written submission

To have your say, make a written submission by 30 April 2019.

Your submission will inform policy development and government decisions.

How to have your say

Your submissions are crucial to help the Government consider improvements to the Act. This discussion document outlines issues within key themes and asks focused questions, so that we can understand your views and experiences.

Download a submission form from www.dia.govt.nz/charitiesact (or use the 'Appendix: Questions to submit on' at the back of this document as a guide). Send your submission by:

- email to charitiesact@dia.govt.nz
- or by post to:
Charities Act Team
Policy Group
Department of Internal Affairs
PO Box 805
Wellington 6140

If you have any questions or want more information about the modernisation work or submissions process, please visit www.dia.govt.nz/charitiesact or email charitiesact@dia.govt.nz.

What happens next?

Submissions received will inform policy development and government decisions. If Cabinet agrees, a new law (a Bill) will be introduced to

Parliament later in 2019, and a Select Committee will invite public comments on specific proposals. Some issues may be addressed through non-legislative change.

Publishing submissions

We will publish all submissions on www.dia.govt.nz. This will include your name, or the name of your organisation, unless you ask for this to be withheld. Your contact details will not be published.

If there is information in your submission that you do not want released, please make this clear and explain why. For example, some information may be confidential because it is commercially sensitive or personal. The Department of Internal Affairs (the Department) will take your request into account.

Under the Privacy Act 1993, submitters have the right to access and correct personal information. When the modernisation work is completed, all documents (including submissions) will be kept by the Department.



Snapshot of the charities sector in New Zealand

Charities make an enormous contribution to New Zealand society, through wide-ranging activities. Many provide services such as education, counselling or religious services. Others make grants, provide facilities, or carry out diverse activities like community patrols, toy libraries or conservation projects.

The size of charities ranges from large tertiary education institutions to small, grass-roots community groups. Some – like the Plunket Society, SPCA, and St John – are household names. Charities form part of the broader not-for-profit sector comprising more than 114,000 organisations that include ethnic associations, Lions Clubs, chambers of commerce and residents' associations.

The public supports the charities sector by volunteering and donating money and other resources. New Zealand's rates of volunteering and donations to charities are high when compared to other countries.¹ Public trust and confidence improves when charities are open about how they use their funds and the public can see the positive difference charities make. Knowing that charities are registered and regulated also drives public trust and confidence.²

Charitable status is granted to organisations that exist for certain purposes and that meet certain requirements. Trusts, incorporated societies, limited liability companies, cooperatives, and unincorporated groups may all be registered charities.

This modernisation work is concerned with

registered charities. That is, organisations that are registered under the Act. We recognise that some organisations may choose not to register, and still call themselves charities if they further charitable purposes.

Charities in numbers

There are approximately 27,000 registered charities in New Zealand.³ They are spread throughout the country. Table 1 shows that more than 14,000 charities are based near our biggest cities: Auckland (7,088), Waikato/Bay of Plenty (3,952), Wellington/Wairarapa (3,878), and Canterbury (3,477).

Table 1: Numbers of charities per region

Region	Number of charities
Northland	1075
Auckland	7088
Bay of Plenty	1826
Waikato	2126
Gisborne	330
Hawkes Bay	901
Taranaki	662
Manawatu/Wanganui	842
Wellington/Wairarapa	3878
Nelson/Marlborough/Tasman	974
Canterbury	3477
West Coast	244
Otago	1705
Southland	811
Total	25,939

The sector employs more than 93,300 full-time and 90,000 part-time staff. Nearly three quarters of charities (about 19,800) have no full-time employees. Just over 2,000 have one full-time employee. Charities are also supported by around 230,000 regular volunteers.

- 1 Charities Aid Foundation CAF World Giving Index 2018: A global view of giving trends. https://www.cafonline.org/docs/default-source/about-us-publications/caf_wgi2018_report_webnopw_2379a_261018.pdf
- 2 Horizon Research Public Trust and Confidence in Charities (December 2016). <https://www.charities.govt.nz/assets/Uploads/Survey-of-Public-Trust-and-Confidence-in-Charities-FINAL-report.pdf>

- 3 This figure is sourced from the charities register. Some information in this document, like the number of charities per region, is sourced from annual returns provided to Charities Services. Totalling the number of charities from annual return figures will vary from the total on the charities register for reasons such as a charity not filing a return, or filing one return on behalf of a group of charities. For example, the number of charities per region in table 1 totals 25,939 charities, rather than 27,000 charities.

The combined total income of registered charities is around \$18 billion per annum, with \$17 billion total expenditure. They manage \$58 billion in total assets.

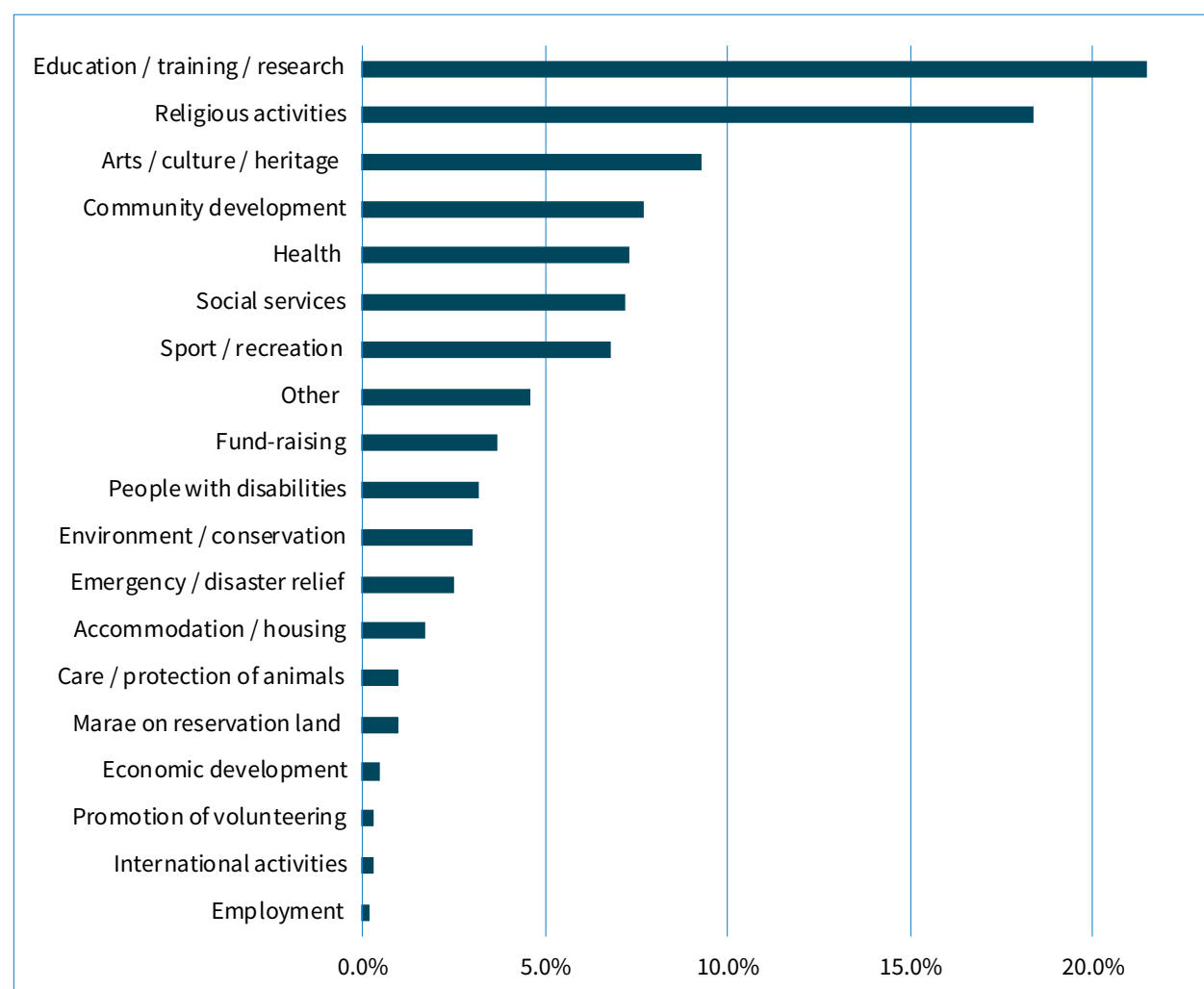
Table 2 shows the percentage of charities within four reporting tiers. This indicates the majority of registered charities are small, though a few very large charities account for half the sector's annual turnover.

Table 2: Expenditure of charities broken into reporting tiers

Reporting tier (based on expenditure)	% of number of charities	Number of charities	% of total annual sector expenditure	Total annual expenditure
More than \$30m (tier 1)	0.7%	163	51%	\$8.67b
\$2m to \$30m (tier 2)	5.7%	1,360	29%	\$4.93b
\$125,000 to \$2m (tier 3)	35.6%	8,493	11%	\$1.87b
Less than \$125,000 (tier 4)	58%	13,838	9%	\$1.53b
Total	100%	23,845	100%	\$17b

Figure 1 shows the largest proportion of charities carry out education, training and research (21%), followed by religious activities (18%). Charities that support arts, culture and heritage are the third most common (9%). The remainder of charities cover everything from environment and conservation, to social services.

Figure 1: Main sectors of registered charities



Case study: Paralympics New Zealand

Paralympics New Zealand (PNZ) is the National Paralympic Committee for New Zealand with a vision of 'Excellence & Equity through Sport'.

As a member of the International Paralympic Committee, PNZ is part of a worldwide social change movement which uses the power of sport to positively influence community perceptions of disabled people and promote a more diverse and inclusive society.

PNZ supports and celebrates the achievements of Para athletes at international and national competitions all year round. Every two years, PNZ leads New Zealand teams to the Paralympic Games. PNZ also works in the local community to advocate for sport to become more accessible for disabled people and support the creation of more systems and programmes to enable participation in Para sport.

On the evening of Saturday 13th April 1968, the New Zealand Federation of Paraplegic

and Physically Disabled Associations was formed. Having a national body, today known as Paralympics New Zealand, meant that New Zealand was for the first time able to send Para athletes to a Paralympic Games. In November 1968, a team of 16 Para athletes travelled to Israel, with Eve Rimmer bringing home four medals from the Tel Aviv 1968 Paralympic Games.

These days, PNZ supports and encourages opportunities for disabled people to participate in Para sports, from regional, national, and international levels. At a national level, PNZ works with regional Parafed organisations to deliver a range of disability sport and recreation programmes, helping disabled people build skills and make community connections. At an international level, PNZ assists elite Para athletes to compete at the Paralympic Games and other key international pinnacle events. A total of 209 Paralympians have represented New Zealand to date.



An overview of the Charities Act 2005

Charities are independent, self-governing entities that bring people together to benefit the public. Like everyone, charities are subject to law.

The Act was passed in 2005, and amended in 2012. Prior to the Act, there was no register of charities and no consistent information about their activities and funding. The 2005 Act established a registration, reporting and monitoring framework, to ensure that ‘those entities receiving tax relief continue to carry out charitable purposes and provide a clear public benefit’.⁴

The Act does not set rules for everything that charities do. Rather, it provides a framework of provisions that seek to promote public trust and confidence in charities.

An independent board, with responsibility for registering and deregistering charities, was established following the Act’s amendment in 2012. Also, the chief executive of the Department was empowered with certain functions (performed by Charities Services), such as educating charities about good governance and management, and monitoring compliance with the Act.

The Act sets out requirements for registration, and outlines duties for charities. These include preparing annual returns, and notifying the Department of particular changes, for example, a change in board membership, or a change to the charity’s rules or purposes.

The reporting and disclosure requirements ensure reliable information is accessible on the register about how charities further their charitable purposes. Among other things, this helps the public make informed decisions about which charities to support with donations or volunteered time.

Other provisions in the Act detail how functions, duties, and powers should be carried out, such as the process the Board must follow if an organisation is to be removed from the register.

⁴ Charities Bill 2004 108-1, Explanatory note, General policy statement.

The Act is not the only legislation that impacts charities. Charities’ tax benefits and obligations come from the Income Tax Act 2007 and other tax legislation, for example.

‘Regulator’

The term ‘regulator’ is used in this document to refer to the bodies that collectively regulate matters under the Act. These bodies currently are:

- the Charities Registration Board (the Board); and
- Charities Services (the business group within the Department which delivers the chief executive's functions - as explained in the Role of the regulator chapter).

The equivalent bodies in Australia and the United Kingdom also describe themselves as regulators.

To some people, the term ‘regulator’ may suggest a strict approach to compliance and enforcement. This is not what we intend to convey. The term ‘regulator’ or ‘regulatory agency’ is a broad term used widely across government to refer to agencies which, among other things, monitor and administer a regulatory system.⁵ Regulatory approaches vary considerably according to the nature of the system.

⁵ See for example Treasury, Government expectations for good regulatory practice (April 2017): “a regulatory agency is any agency (other than courts, tribunals and other independent appeal bodies) that has any of the following responsibilities for the whole or part of a regulatory system: monitoring; evaluation; performance reporting; policy advice; policy and operational design; legislative design; implementation; administration; information provision; standard-setting; licensing and approvals; or compliance and enforcement.”

Context for modernising the Act

Background

In May 2018, the Government announced it would review the Act. The aim is to ensure the Act is effective and fit-for-purpose, with sufficient flexibility to suit the needs of diverse charities.

The charities sector has consistently called for a review ever since the Act was passed. The Act passed in 2005, following more than 700 public submissions on the 2004 Bill and significant alterations during the select committee process. Consultation on the revised Bill was limited, and the Bill moved through its final parliamentary stages under urgency.

In 2010, the former Minister for the Community and Voluntary Sector began an intended ‘first principles’ review of the Act. However, in 2011, the incoming Government disestablished the Charities Commission, transferring its functions to the Department of Internal Affairs and an independent Charities Registration Board. Cabinet decided in 2012 not to continue with a review, as the new regulatory regime was still bedding in.

There has been significant change since the Act was passed 14 years ago. This includes changes in charities’ wider operating environment (for example, increasing pressure on volunteers and growth in innovative fundraising methods), the move to a Board, the introduction of financial reporting standards for charities, and new tax obligations for deregistered charities. More broadly, the Crown-Māori relationship is maturing as the number of Treaty settlements grows.

It is timely, therefore, to consider the Act's operations. This means looking at how well the Act is working for charities, recipients of charitable support, volunteers, donors, the Government, and all others with an interest. The Act needs to work for everyone.

Case study: One Percent Collective



In 2012, One Percent Collective formed to simplify regular giving. It is a registered charity that exists to inspire generosity so that charities can spend more time working on impact and innovation, and less time on fundraising.

Donors set up regular payments – often just 1% of their income – to one or more of the 14 partner charities through One Percent Collective’s website. It’s about making a big difference through lots of people contributing small amounts.

One Percent Collective takes care of the advertising and publicity, leaving the partner charities to focus on the issues they exist to solve. The partner charities are all New Zealand-based with charitable purposes ranging from providing quality food to vulnerable people to protecting the environment. They are small to medium charities with annual expenditure below \$500,000 when they first join the Collective, and they must adhere to One Percent Collective’s values of being “open, human, and real”.

One Percent Collective itself is funded by the Future 50 – a group of 50 individuals and local businesses donating \$20 a week to fund core expenses. Corporate sponsors help fund the rest of the operating costs which means that the partner charities receive 100% of the money donated specifically to them. Since its establishment, One Percent Collective has raised over \$1 million and currently has over 500 donors.

One Percent Collective puts huge effort into sharing stories on what the partner charities do with their donations. This includes monthly feature stories, interviews with staff and volunteers, and regular profiles of donors. One Percent Collective holds annual Generosity Sessions to further encourage meaningful connection between donors and charity staff and volunteers. Plus you may have seen their Generosity Journal publication, which helps them reach new audiences through print.

Scope

The Government considers the fundamentals of the legislative regime are proving to be sound. These include:

- provision for the registration of charities;
- the voluntary nature of registration;
- public access to information about charities; and
- the obligation on charities to file annual returns with financial statements.

Nevertheless, the sector has raised various issues with the current state. These range from 'big picture' issues, such as the independence of the Board, to operational issues, such as the reporting standards. The regulator has also identified areas to improve, such as appeal mechanisms.

The terms of reference define the structure and scope of the modernisation work. Following initial information gathering and sector conversations, we have identified various substantive issues which we seek feedback on:

- Can we improve on the purposes of the Act?
- Are the duties and obligations placed on charities too onerous or too light touch?
- Could the accessibility or content of the charities register be improved?
- Do current regulatory arrangements protect the sector's independence, and strike the right balance of support versus compliance?
- Could current mechanisms for the appeal of registration decisions be improved?
- How well is the Act working for Māori charities and Māori communities?
- What limits, if any, should exist on charities running businesses or advocating for their views?

The following chapters broadly reflect the order of these questions. This list is not necessarily exhaustive and we welcome feedback on other elements of the Act. We also welcome your views on what is working well. The full terms of reference for the modernisation work, and other related documents, can be found at www.dia.govt.nz/charitiesact.



Out of scope issues

The following matters are outside scope:

- operational issues, that is how Charities Services does its job;
- the definition of 'charitable purpose' (section 5(1) of the Act), which will continue to be based on court judgments;
- tax exemptions for registered charities;
- regulation of the broader not-for-profit sector; and
- contracting arrangements for charities delivering government services.

Other work occurring at the same time

Independent Tax Working Group

The Tax Working Group (the TWG - <https://taxworkinggroup.govt.nz/>) is an independent body established by the Government to examine further improvements in the structure, fairness and balance of the tax system. The TWG considered the tax

treatment of charities as part of its work. The TWG's final report was publicly released on 21 February 2019.

Tax exemptions for registered charities are not within the scope of the work to modernise the Charities Act. However, some issues noted by the TWG have been picked up, for example, the issues around accumulation of funds by charities.

Incorporated Societies Bill

Many charities are incorporated societies, and will be impacted by upcoming changes to incorporated societies legislation. Public comment on an Incorporated Societies Bill was sought over 2015 and 2016. An Incorporated Societies Bill is expected to progress through the parliamentary process in 2019.

Trusts Bill

Many charities are trusts. The Trusts Bill seeks to replace the Trustee Act 1956 and the Perpetuities Act 1964. It has three main purposes: to set out clear and accessible trust principles, to ensure more efficient administration of trusts, and to clarify and simplify the role of the courts. As of February 2019, the Trusts Bill is awaiting its second reading.

Other

Other work underway (for example the Welfare Expert Advisory Group's review of the welfare system), also forms part of the broader context in which the modernisation of the Charities Act is occurring.

Vision and policy principles

An effective, healthy charities sector contributes to building resilient and cohesive communities and improving living conditions for all New Zealanders.

Charities can support New Zealanders' wellbeing in many ways – for instance, through work to protect our natural environment; enhance people's skills, knowledge and health; and provide community facilities. The sector enables participation, builds bonds within and between communities, and supports intergenerational wellbeing.

Given the foundation provided to the wider legislative frameworks by the Treaty of Waitangi, the Act must reflect the Crown-Māori relationship. This is continually evolving as historical grievances are settled. The Act should support these relationships into the future.

? What are the key challenges facing the charities sector over the next ten years?

? What are the key opportunities facing the charities sector over the next ten years?

A well designed and effective Act will contribute to a thriving and sustainable charities sector where:

- New Zealanders understand, trust, and have confidence in charities;
- charities have the capability and capacity to deliver effectively on their charitable purposes, and New Zealanders benefit as a result; and
- the expertise and independent voice of charities helps inform the policies and services that affect the communities they work with.

? What is the role of government in achieving this vision?

In considering any changes to the current legislative regime, we will think about any measures in terms of these policy principles.

- Certainty – the objectives of the Act, the

obligations of charities and the functions and powers of the regulator should be clear.

- Transparency and accountability – both charities and the regulator must be accountable to the public.
- Flexibility – the regulatory framework must work for charities of all different sizes and purposes and adapt to future technology and circumstances.
- Proportionality – the obligations placed on charities, and the regulator's response to non-compliance, should reflect the potential risk to charitable funds or public trust in the charities sector.
- Cost-effectiveness – obligations on charities should be no more onerous and costly than necessary, and the cost of regulating the regime should be reasonable.
- Equity – charities in similar situations should be treated consistently, including in their access to appeal decisions that affect them.
- Alignment – the Act's regime should align as much as possible with other legislative regimes (including international frameworks).

? Do you agree with the vision and policy principles described here?

? Would you remove or change any part of the vision and policy principles?

The purpose of the Act

Most modern Acts have a purpose section which ‘sets the scene’ and clearly conveys the high-level outcomes each Act seeks to achieve. All the functions, powers and duties in the remainder of the Act are interpreted in light of the Act’s purpose section.

Section 3 states the purpose of the Act is to:

- promote public trust and confidence in the charities sector;
- encourage and promote the effective use of charitable resources;
- provide for the registration of societies, institutions, and trustees of trusts as charitable entities;
- require charitable entities and certain other persons to comply with certain obligations;
- provide for the Board to make decisions about the registration and deregistration of charitable entities and to meet requirements imposed in relation to those functions; and
- provide for the chief executive to carry out functions under the Act and to meet requirements imposed in relation to those functions.

Potential additional purposes

We are interested in your feedback on the following two possibilities for additional purposes.

To support and sustain a robust, vibrant, independent, and innovative charities sector

This purpose would emphasise the government’s commitment to supporting charities to achieve their purposes through the Act’s framework. It is similar to the objective of the Australian Charities and Not-For-Profits Commission Act 2012, section 15-5(1)(b).

To promote the transparency of the charities sector to donors, volunteers, beneficiaries and the public

Transparency is a key concept underlying the Act, through the publicly accessible register of charities, and reporting obligations on charities. This purpose would emphasise the importance of transparency to donors, volunteers, beneficiaries and the public.

- ? Do you agree with either of the two possibilities for additional purposes?
- ? Are there any additional purposes you think should be added to section 3?



Obligations of charities

Introduction

This section seeks your views on charities' obligations under the current legislative framework.

Organisations must meet certain obligations to qualify for and maintain charitable status. These obligations ensure the register has sufficient rigour and scrutiny to support trust and confidence in charities. Ultimately, non-compliance can lead to charities being removed from the register.

The obligations need to be clear, so that charities understand what is expected. Obligations must also be manageable, so they do not get in the way of charities carrying out their work.

Registration as a charity provides exemptions from income tax. Charities may also receive donee status, which means individuals who donate to those charities may be able to claim a tax credit, and companies and Māori authorities may be able to claim a deduction.⁶ Charities may also receive exemptions from resident withholding tax and fringe benefit tax.

Registered charities receive other benefits from government. For example, the New Zealand Police grant a fee waiver for vetting staff and volunteers. Some local authorities give rent reductions, rates exemptions, or rates rebates to registered charities.

Some small charities receive little or no tax benefit from registration,⁷ but registration provides other benefits such as public status and credibility. Some funders will only consider applications from registered charities. Many businesses also offer discounts or donated goods and services to registered charities.

? Why did your organisation register as a charity? For example, was the main reason public recognition, or to meet a funder's requirements, or tax benefits?

? What benefits does your charity experience from being registered under the Act?

Current situation

Under section 13 of the Act, to qualify for registration, an organisation must:

- if it is a trust, have income derived by the trustees in trust for charitable purposes;
- if it is a society or an institution, be established and maintained exclusively for charitable purposes, and not be carried on for the private profit of any individual;
- have a name that is not misleading or offensive;
- have officers (key personnel such as trustees, board members, and senior leadership) that are qualified to be officers of a charity (for example, they must be over 16, not be an undischarged bankrupt, and not have been convicted of certain crimes involving dishonesty); and
- have a rules document.

The Act has no specific provisions for overseas organisations seeking to register as a charity in New Zealand. However, Charities Services requires a charity to be either established in New Zealand or have a very strong connection to New Zealand.

To remain on the register, a charity must meet certain duties, such as notifying Charities Services of changes to its name or address, officers, rules or purposes (section 40). Charities also have reporting requirements, detailed below.

Requirements associated with maintaining registration

Maintaining charitable purpose

If a charity changes its rules or purposes, it must notify Charities Services. These changes are reviewed to ensure the charity still meets the requirements for registration.

⁶ The proposed changes in the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Bill require that organisations with charitable purposes must be registered charities in order to obtain donee status.

⁷ Around 1,900 registered charities reported less than \$1,000 in total gross income and received less than \$100 in donations in their most recent financial year.

If the charity's purposes are no longer charitable, Charities Services may work with the charity to help them stay registered, for example advising on proposed changes to the wording of purposes in their rules document. If the charity takes no action to amend its purposes, Charities Services may recommend that the Board deregister the charity.

Annual reporting

Charities must file an annual return form and accompanying performance report within six months after the financial year end. The performance report (which includes financial statements) allows charities to 'tell their story' for the past year: why they exist, what they did over the last year, how much this cost, and how it was funded.

Information in these documents can be searched on the publicly accessible charities register, unless it is withheld in the public interest (under section 25). Data from annual returns helps government, funders and the public understand the charities sector, for example, by showing the number and types of charities in a particular region.

Financial reporting requirements

The new financial reporting standards came into effect on 1 April 2015. This followed a review of the quality of charities' annual reporting in 2009 by the then Ministry of Economic Development. The review identified problems with charities' financial statements, including widely varying formats and accounting approaches, and concerns with the completeness and quality of information reported.

To address these issues, the Act was changed in 2013.⁸ The changes required charities to prepare annual financial statements in line with standards that the External Reporting Board (XRB) consulted on and issued.⁹ The standards provide a consistent approach to reporting. This is important for

accountability, since all charities can receive donations from the public.

Requirements are tiered according to the size of the charity. The terms are generally based on the charity's annual expenditure over the previous two financial years (see Figure 2). Larger charities have more rigorous reporting requirements.

Figure 2: Tiered reporting standards for charities based on annual expenditure¹⁰

Tier 1	Tier 2	Tier 3	Tier 4
Full Standards	Reduced Disclosure Regime	Simple Format Report – ACCRUAL	Simple Format Report – CASH
Over \$30 million annual expenses	Under \$30 million annual expenses	Under \$2 million annual expenses	Under \$125,000 annual operating payments
or has public accountability	without public accountability	without public accountability	without public accountability

The vast majority (94%) of registered charities use the simplified tier 3 (accrual) and tier 4 (cash) standards. These charities must prepare performance reports, including both financial and non-financial information (such as the charity's mission or purpose, and what services they delivered). Templates and guidance notes are provided.

A comprehensive suite of tier 1 and tier 2 standards apply to the preparation of financial statements by large charities.

Charities' financial reports indicate how well they are financially placed, in terms of what they owe and own. Notes can be included, such as about transactions involving the transfer of money, goods and services between the charity and those who are closely associated with, and have the ability to influence, the charity.

⁸ Financial Reporting (Amendment to Other Enactments) Act 2013.

⁹ The External Reporting Board is an independent Crown Entity responsible for accounting and auditing and assurance standards in New Zealand. It sets reporting standards for charities and other organisations under the Financial Reporting Act 2013.

¹⁰ This figure also refers to 'public accountability'. Paragraphs 7-13 of XRB Accounting Standard XRB A1 define 'public accountability' for financial reporting purposes and includes, for example, entities that have issued debt or equity securities in a public market.

Audit and review requirements

Charities with operating expenditure over \$500,000 must have their performance report or financial statements audited or reviewed by a qualified auditor. Charities with annual operating expenditure over \$1 million must have their performance report or financial statements audited by a qualified auditor.

Support provided to charities in meeting their obligations

Following introduction of the reporting standards, Charities Services, XRB, and others worked to raise awareness of the new requirements and to help charities comply. This involved workshops throughout the country, webinars, other online resources, and responses to questions. These efforts have focused on supporting charities that report under the tier 3 and 4 standards.

Many accountants also contribute significantly to charities, freely giving their time and skills. Many are treasurers and board members, or provide audit and assurance services, to not-for-profit groups.¹¹

What are the issues?

We would like to hear your feedback on the requirements and duties of charities. Some issues we are aware of are below.

Many small charities struggle to meet reporting requirements

Charities Services data shows that in 2018, 100% of tier 1 charities, 91% of tier 2 charities, 81% of tier 3 charities, and 58% of tier 4 charities successfully met the minimum reporting requirements.

While this is an improvement on previous years, many small charities are struggling to meet requirements. On average, only about 50% of

charities (of all sizes) file their returns on time.

A charity's ability to meet its financial reporting obligations depends on both the complexity of the obligations, and the skill and knowledge of that charity's people: volunteers, managers and board members.

Tier 4 charities are the most likely to rely on volunteers who may be time poor, or less familiar with obligations than paid staff in large charities. Governance boards of tier 4 charities often face similar barriers. It may be that small charities need more support and advice, or need to build their own capacity to meet the reporting standards.

Some have proposed that a new 'micro entity' tier be created for charities with \$10,000 or less operating expenditure. These charities would not need to comply with the current XRB reporting standards. For example, they would instead complete a fill-in-the-box financial statement form annually, containing minimum financial information (without non-financial information). Alternatively, tier 4 charities could be required only to file an annual return (without accompanying performance reports or financial statements).

However, reducing reporting requirements for small charities also has some downsides. For example, an annual return form could be inflexible and not a good fit for all small charities. In addition, removing the non-financial information about what a charity has done in a year will not allow the charity to tell its story to the public.

- ? Is more support required for charities to meet their obligations? If so, what type of support is needed?
- ? Should reporting requirements for small charities be reduced? If so, what would be the benefits? What would be the risks?

Definition of an officer

Responsibility for filing annual returns, and notifying Charities Services of key changes, rests with the charity. The charity's officers are responsible for ensuring these duties are met.

The definition of an officer depends on the legal

11 Chartered Accountants Australia and New Zealand (2016) *What Really Counts: The contribution of Chartered Accountants Australia and New Zealand members to the Charitable and Not-for-Profit sector* available at <https://www.charteredaccountantsanz.com/news-and-analysis/news/ca-support-for-nfp-groups-revealed>. The survey, which covered both Australian and New Zealand accounting professionals, found that respondents donated over 40,000 days in support of Not-for-Profit organisations in 2015.

structure of a charity. If the charity is a trust, the Act (section 4) indicates that the officers are the trustees. For all other legal structures, the officers are members of the board or governing body, and all people in positions of significant influence over the entity's management or administration (for example, a treasurer or chief executive).

Because officers in trusts are more narrowly defined, not everyone with significant influence over the management or administration may be captured. For example, in some trusts, trustees may delegate some of their powers to committees or boards. Those committee members are not captured by the Act's current definition of 'officer'.

Some trusts have corporate trustees (for example, a company) rather than natural person trustees. The current definition of 'officer' does not include the officers of those corporate trustees although they may play a significant role in the operation of a trust.

In Australia, the 'responsible persons' of a trust includes the directors of any corporate trustees.

- ? Should the definition of 'officer' be broadened for trusts that are registered charities?

Qualification of officers

One of the registration requirements is that all officers of the entity must be 'qualified'. Under section 16, officers are disqualified if they have been convicted and sentenced for a crime involving dishonesty within the last seven years. These offences cover theft, burglary, robbery, obtaining by deception, money laundering, receiving, accessing computer systems for dishonest purposes, forgery, and (recently) tax evasion.

The Board has discretion to waive a disqualifying factor for an officer of an entity in any particular case. This provides flexibility to allow persons who would otherwise be disqualified to be officers in appropriate situations. For example, charities, specifically established to support current and former inmates, may benefit from officers with past experience of prison.

Currently, individuals with serious convictions (including serious drug offences, murder, and sexual violation) can be officers of registered charities.

Nothing in the Act disqualifies them, even in cases of charities that work with vulnerable people.

- ? Should someone with serious convictions be disqualified from being an officer of charity? If so, what kinds of convictions?

Accumulation of funds

Generally, charities need to set aside funds to deal with both expected and unexpected events. For example, charities need to have funds to cover an unexpected drop in income.

Some charities may accumulate considerable funds (or other assets) over many years. There are often good reasons for this. For instance, a charity may accumulate funds:

- for a specific purpose, like a new community facility, by fundraising over a long period;
- to grow a charity's own business so that it can provide future income for the charity, by putting business income back into the business; or
- to ensure the charity can provide benefits to current and future generations, by managing and growing a charity's assets (including iwi and hapū charities that hold settlement assets).

In other cases, a charity may accumulate funds over many years with no clear rationale. While charities must use their funds for charitable purposes, the Act does not limit the funds a charity can accumulate before doing so.

Tier 1- 3 charities must report annually on the funds they have accumulated over their lives. Tier 1-3 charities also need to state their reserves – funds set aside for a particular purpose – and must describe the restrictions or purposes for their reserves. Tier 4 charities do not need to report on the funds they have accumulated over their lives but must report on the amount of cash they have and other resources they own.

Holding accumulated funds without clear explanation may cause public concern that a charity is not using its funds for charitable purposes. For example, concerns have been raised regarding charities with businesses that apply very little or no

funds to charitable purposes. Accumulating funds in a business or other investment over a long time can increase the risk that charitable funds are lost if it fails (see chapter on charities and business).

Case study: Charity (accumulation of funds by a business)

A charity group is made up of a trust that owns six related companies. The companies provide goods and services for the building industry. The charitable purpose of the trust is to provide grants for charitable purposes in the community.

Over the past 10 years, the companies have provided on average \$2.5 million in income to the trust annually.

At the same time, the group's assets have grown from \$30 million to \$90 million. The trust has used accumulated funds and taken out loans to purchase \$30 million in property. The property is rented by the six subsidiary companies.

The trust makes charitable grants of \$100,000 annually on average. That is about 4% of its income and less than 1% of its total assets.

In this case, there has been large growth in assets over a long period and a relatively small amount distributed in grants. So far, most of the accumulation of funds by the trust has not advanced the charitable purposes of the trust.

It is not only charities that operate businesses that have issues with large accumulation of funds. For example, the TWG's interim report raised concerns about accumulation by private foundations.¹² Financial information on the charities register indicates the largest 25 to 30 foundations established by single donors or their families have total assets exceeding \$1.7 billion. The TWG reported that the average proportion of net surplus by private foundations distributed over this three year period varies widely, from 10% to 92%.

Other countries take different approaches to this issue. In England and Wales, all charities must include in their annual report their policy on reserves, stating the level of reserves held and why they are held. The charity needs to state if it does not have a reserves policy.

In Canada, charities are required to spend a minimum amount each year on their own 'charitable programmes' or on gifts to other charities.

In Australia, private foundations that are registered private ancillary funds need to meet specific rules. If a private ancillary fund is a charity, it is required to have a minimum annual distribution of 5% of assets to charitable organisations.

- ? Should charities be required to be more transparent about their strategy for accumulating funds and spending funds on charitable purposes (for example, through a reserves policy)? Why? Why not?
- ? Should certain kinds of charities be required to distribute a certain portion of their funds each year, like in Australia?

Governance standards

Some of the issues described above, including the accumulation of funds, could be addressed through the introduction of governance standards for charities. In Australia, charities must meet core, minimum governance standards that require charities to remain charitable, operate lawfully, and be run in an accountable and responsible way.¹³ The standards set out high-level principles, not precise rules, so there is flexibility in terms of how charities can comply.

Case study: Australian governance standards

Standard 1: Purpose and not-for-profit nature

Australian charities must be not-for-profit and work towards their charitable purpose. They

¹² Tax Working Group, *Future of Tax: Interim Report* (20 September 2018) at page 121 <https://taxworkinggroup.govt.nz/resources/future-tax-interim-report>

¹³ Charities must meet specific governance standards to maintain their charitable registration <http://www.acnc.gov.au/ACNC/Manage/Governance/ACNC/Edu/GovStds/overview.aspx>.



must be able to demonstrate this and provide information about their purposes to the public.

Standard 2: Accountability to members

Australian charities that have members must take reasonable steps to be accountable to their members and provide them with adequate opportunity to raise concerns about how the charity is governed.

Standard 3: Compliance with Australian laws

Australian charities must not commit a serious offence (such as fraud) under any Australian law or breach a law that may result in a penalty of 60 penalty units (A\$10,200) or more.

Standard 4: Suitability of Responsible Persons

Australian charities must take reasonable steps to be satisfied that its responsible persons (such as board or committee members or trustees) are not disqualified from managing a corporation under the Corporations Act 2001 or disqualified from being a responsible person of a registered charity by the Commissioner for the Australian Charities and Not-for-profits Commission, and remove any responsible person who does not meet these requirements.

Standard 5: Duties of Responsible Persons

Australian charities must take reasonable steps to make sure that responsible persons are subject to, understand and carry out the duties set out in the standard (including acting with reasonable care and diligence, acting honestly in the best interests of the charity and for its purposes, not misusing their position as a responsible person, disclosing conflicts of interest, and ensuring that the charity's financial affairs are managed responsibly).¹⁴

- ?

Do you think governance standards could help charities to be more effective? Why?
- ?

Do you think the Australian governance standards could be adapted to work in New Zealand?

Alignment with other legislation

Most charities must comply with other legislative regimes in addition to their obligations under the

¹⁴ The duties are set out in full here: http://www.acnc.gov.au/ACNC/Manage/Governance/ACNC/Edu/Duties_RespPersons_std5.aspx

Act. Ideally, the requirements of different legislative regimes should align as much as possible.

Of the registered charities in New Zealand:

- 3.5% are subject to the Companies Act 1993;
- 25% are subject to the Incorporated Societies Act 1908;
- 38% are subject to the Charitable Trusts Act 1957; and
- most of the remainder are unincorporated societies and trusts.

Charities are also subject to more general legislation such as the Employment Relations Act 2000 and the Health and Safety at Work Act 2015. As noted earlier, charities' tax benefits and obligations come from the Income Tax Act 2007 and other tax legislation.

The Income Tax Act 2007 and the Tax Administration Act 1994

The Tax Administration Act 1994 allows the Commissioner of Inland Revenue to make binding rulings on how taxation law applies to income derived by, or for the benefit of, charities. The Income Tax Act 2007 provides tax concessions for entities that carry out charitable purposes.

Under section 13 of the Charities Act, the Board is required to follow any binding ruling by Inland Revenue when deciding if an organisation meets registration requirements for charitable purposes. It is possible that the Board will be bound to follow an interpretation of charitable purpose that it does not agree with.

- ? Should the Charities Registration Board continue to be bound to follow charitable purpose interpretations made by the Commissioner of Inland Revenue?

Role of the regulator

Introduction

This section focusses on the role and activities of the regulator in administering the Act's registration, reporting and monitoring framework.

The term 'regulator' describes an agency with responsibilities for a regulatory system such as monitoring, administration, information provision, licensing, compliance, and enforcement.

We are interested in your views on how well current arrangements are working to promote public trust and confidence in the charities sector, and to encourage the effective use of charitable resources.

Specifically, this chapter seeks your views on:

- the role and functions of the regulator;
- the accountability of the regulator;
- processes for registration and deregistration decisions;
- compliance functions and tools; and
- other issues, such as the regulator's education function, and funding.

Current situation

Under the Act, regulatory functions are split between two bodies: the Charities Registration Board (the Board) and Charities Services (a business group within the Department of Internal Affairs). Below we describe their respective responsibilities.

Having two bodies (the Board and Charities Services) carrying out regulatory functions can be confusing for the public and the sector. For some, it is because one body, the former Charities Commission, used to carry out all of the functions that the Board and Charities Services now perform. On its face, the Board's responsibility to make registration and deregistration decisions under the Act is clear. In practice, however, most decisions are delegated to Charities Services to make. Charities Services also supports the Board to make its own decisions with a recommendation and written reasoning.

The Charities Registration Board

The Board comprises three members appointed by the Minister for the Community and Voluntary Sector. The Board is not subject to the Minister's direction and members must act independently in exercising their professional judgement.

The Board is responsible for deciding applications for registration. If it is satisfied that the entity qualifies, the Board must grant the application and direct the chief executive to register the entity as a charity. The Board can also direct that an entity be removed from the register.

The Board can regulate its own procedure. The Board must still observe the rules of natural justice, and give entities a reasonable opportunity to make submissions on registration and deregistration matters.

When making decisions to register or deregister charities, the Board applies the law (from the Act, and from court judgments).

Under section 9, the Board can delegate any of its functions to the chief executive of the Department, who in turn, delegates to Charities Services. In practice, the Board delegates the vast majority of registration and deregistration decisions to Charities Services. The Board has an important role in providing guidance to Charities Services on applying the law. For example, guidance on 'serious wrongdoing' and how the definition of 'charitable purpose' applies to specific situations. This guidance is important, as the Board remains responsible for decisions that Charities Services makes under delegation.

The small number of registration and deregistration decisions that the Board makes primarily focus on novel or complex decisions. In making these decisions, the Board receives from Charities Services a recommendation, written reasoning, and all material that the organisation has provided to Charities Services. The Board may agree or disagree with Charities Services' recommendation, or ask for further information. However, the decision is the Board's.

The Board is accountable for its decision-making through the appeal or judicial review of its decisions

to the courts, as well as through complaints to the Ombudsman. The appeals chapter of this document discusses this further. Board decisions are published online.

Charities Services (Department of Internal Affairs)

Charities Services performs two kinds of functions. Firstly, under section 10 of the Act, it provides educational support and advice to charities, maintains the charities register, and monitors and promotes compliance. These day-to-day operations are covered later in this chapter.

Secondly, Charities Services makes decisions to register or deregister charities under delegation from the Board, and following the Board's guidance. These decisions remain the Board's responsibility, and can be appealed, like other registration or deregistration decisions. Like the Board, Charities Services must apply the law and perform this registration and deregistration decision-making role independently of both the Minister and charities.

Information on Charities Services' performance is published in the Department of Internal Affairs Annual Report.¹⁵ This includes the results of an annual independent assessment of randomly sampled regulatory decisions. In 2017/18, 97% of these decisions were assessed as meeting the required quality and timeliness.

Section 12 of the Act requires an annual meeting between Charities Services and charities sector representatives where charities can question the operation of the Act. At this meeting, Charities Services reports on the past year's activities and future plans.

Charities Services' decisions can be judicially reviewed. Charities and the public can also hold Charities Services to account for its actions or decisions through complaints to the Ombudsman, and can request information under the Official Information Act 1982.

Registration and deregistration decision-making

The Act sets out the process and procedural obligations and safeguards when considering registration applications. Table 3 shows that 1,087 applications were received in 2017/18, with 815 approved, 4 declined and 268 withdrawn.

Table 3: 2017/18 registration decisions

Total applications	Outcome	Number	Decision-maker
1,087	Application approved	813	Charities Services (under delegation)
		2	Board
	Application withdrawn	268	"Decision-maker" is not applicable. (This is because withdrawals are either: applications the Act treats as withdrawn or applications actively withdrawn by the applicant.)
	Application declined	4	Board

Section 32 of the Act sets out when a charity can be deregistered. Typically, around half of deregistrations are made at the charity's request, mainly because they are no longer operating. Most of the remaining deregistrations are due to the charity having failed to file annual returns for two or more years.

Over the last five years, 11 charities have been deregistered for other reasons, including because charitable purposes were not advanced, or because of serious wrongdoing. In 2017/18, the Board made one deregistration decision, with Charities Services making all remaining deregistration decisions under delegation (see Table 4).

¹⁵ In 2017/18 Charities Services published its own Annual Review.

Table 4: 2017/18 deregistration decisions

Grounds for deregistration		Number of decisions to deregister on this ground
Charity requested removal from register		563
Decision to deregister because charity did not file annual returns for 2 or more years	Deregistered by Charities Services	506
	Decision to deregister by Board	1
Total		1070

Maintaining the charities register

Charities Services maintains the charities register. The register is a publicly available, central resource of data on a charity's purpose, officers, staff and volunteer numbers and hours, and annual financial performance. The register is a rich source of information for the public, funders, government agencies, charities, researchers, and the media.

Information on the register is taken from applications for registration and annual returns. In some cases, public access to information can be restricted in the public interest. The addresses of women's refuges are withheld to protect the women accessing its services, for example.

The register is live, which means up-to-the-minute data is available to the public. The data is open, so people can access and use the data for whatever legal purposes they choose.

Compliance functions and tools, including education

Charities Services uses a range of education and compliance tools shown in Figure 3.

Education functions

Charities Services' education work involves providing information, support and guidance to help charities meet the requirements of the Act.

Figure 3: Features of compliance approaches



Since the introduction of new reporting standards in 2015, Charities Services has focused its education activities on helping charities meet these requirements. It has produced blogs, webinars, workshops, clinics and other resources. The proportion of charities successfully reporting has increased over this period. Charities Services is working on a project to support good governance in the charities sector.

Registered charities are also provided other assistance and support to meet requirements. For example, they can call or email questions to Charities Services, and are sent regular reminders about the need to file annual returns.

Powers of investigation

Charities Services has broad powers in the Act to examine and inquire into any registered charity, where this is reasonably necessary. An investigation will generally only be initiated where:

- initial inquiries indicate possible serious or deliberate non-compliance with the Act, and/ or possible serious wrongdoing by the charity

or someone connected with it; and

- an assessment of the nature and level of risk to public trust and confidence relating to the issue or allegation indicates an investigation is appropriate.

Definition: Serious wrongdoing is defined in the Act as:

- an unlawful or corrupt use of a charity's funds or resources;
- an act, omission or course of conduct that constitutes a serious risk to the public interest in the orderly and appropriate affairs of a charity;
- an act, omission or course of conduct that constitutes an offence; or
- an act, omission or course of conduct by a person that is oppressive, improperly discriminatory, grossly negligent or that constitutes gross mismanagement.

If an inquiry or investigation uncovers concerns that need to be addressed, there are a range of possible outcomes. These include working with the charity to resolve any issues, warnings, and deregistration. Powers further up the pyramid (in Figure 3) may be used where Charities Services assesses there is a risk to public trust and confidence, and to the effective use of charitable resources. The powers at the top of the pyramid are used in the most serious cases.

What are the issues?

Strengthening connections between the regulator and the charities sector

The work of the Board and Charities Services is critical to all charities in New Zealand. Given the size of the sector, there are limits to how accessible these bodies are to charities. Charities Services has 38 staff and has shifted towards a greater online presence and electronic communications, with fewer face to face interactions.

Mechanisms connecting the regulator and the charities sector vary across countries. For example, the Scottish regulator is required to consult with representatives of the charities sector before issuing particular guidance. More formally, the Australian regulator receives advice and recommendations on its functions from a Ministerially appointed advisory board.

- ? How could the regulator be made more accessible to charities? For example, what would consultation requirements or an advisory board achieve?
- ? Are the current accountability mechanisms for the Charities Registration Board and Charities Services (described above) adequate? How could accountability be improved?

Registration decision-making could be strengthened

The Act does not specify the type of information to be provided in support of an application for registration (for example, about the applicant's purpose or activities) or how such information should be assessed when the application is considered.

Some commentators are concerned that without

better guidance, small or new organisations may not be able to determine the evidence they need to provide. This can also create problems for the regulator and the courts when making decisions on charitable purpose, as it is not clear what kind of evidence should be considered beyond the applicant's constituting document.

The Board is not required to apply any rules of evidence while deciding an application. The sector has raised concerns about this, particularly relating to the use of internet searches which may lead to the Board taking into account incorrect or outdated information. On the other hand, Charities Services always informs the applicant of the information it provides to the Board in advance.

When considering an application for registration, the Board does not hear oral evidence in support of the application. Some in the charities sector are concerned that there is no 'trier of fact'. That is, there is no body before which evidence is called and tested so as to prove questions of fact. Without traditional court mechanisms for calling and testing evidence, some consider that applicants are disadvantaged. They are concerned that applicants may be further disadvantaged in any subsequent appeal, because the court will only consider information provided in the initial application (see Appeals chapter).

On the other hand, the Act requires the regulator to observe natural justice in considering applications, and prescribes the process for notifying an applicant where an application may be declined.

- ? How could rules and processes for registration decision-making be improved?

Perceptions of independence

Registration decisions are fundamental to the integrity of the system. To be effective, the regulator must make decisions that are 'free from the direct control of politicians and regulated parties'.¹⁶ We are also interested in better understanding concerns that current regulatory arrangements may not ensure independent decision-making.

16 New Zealand Productivity Commission, "Regulatory institutions and practices", June 2014 at p.216.



Some commentators saw this independence as compromised when some functions of the disestablished Charities Commission shifted to Charities Services, within a government department. However, it is not unusual for regulatory functions like educating, informing, investigating and monitoring to sit within government departments.

When it was disestablished, the Charities Commission's functions of registering and deregistering charities shifted to the Board. The Act explicitly requires the Board to act independently, and Board members are not subject to direction from the Minister.

However, independence is determined by more than just structural form. It also depends on who makes decisions, the decision maker's level of discretion, accountability for performance, and transparency of decision-making. Any perception that key decision-makers lack independence could undermine trust and confidence in the charities framework.

Changing the regulator's structure could address concerns over the independence of decision-making. But structural changes could be disruptive

and a distraction, and require significant establishment costs.

- ? What is driving concerns over the independence of decision-making by the regulator?
- ? Would alternate structures or governance arrangements address any perceived lack of independence in decision-making?

Can the charities register be improved?

We are interested in suggestions for how to improve the register for charities and the public. The register details a charity's purpose, officers, staff and volunteer numbers and hours, and annual financial performance.

Publicly accessible information enables research and informed decision-making (for instance, helping funders when assessing a charity's funding application, or informing a person choosing a charity to volunteer with).

- ? How could the register be improved?

The Act may not provide all the right regulatory tools to ensure compliance

Recent investigations by Charities Services into misconduct and mismanagement have highlighted potential gaps in its statutory powers. It considers that a more fit-for-purpose 'regulatory toolbox' would enable it to do both a better job of investigating and sanctioning serious wrongdoing, and take a more effective and proportionate approach to addressing non-compliance.

Charities Services has identified potential new regulatory tools that it considers would better support the regulator to administer the Act.

The Board's powers when considering applications for registration

There are a number of limitations on the Board's powers when considering applications for registration.

For example, the Board has no ability under the Act to decline to register, or subsequently remove, an organisation that provides false or misleading information.

Additional powers could help the Board to ensure that only organisations that meet requirements are registered as charities.

Another example is that currently the Act does not require a deregistered charity to show it has addressed the issues that led to deregistration when it applies for re-registration. Persistent failure to file annual returns is the main reason for deregistration, but the Act does not require a charity deregistered for this reason to show it will better meet its filing obligations in future.

The Board also has no powers under the Act to backdate a registration to a point earlier than the date a completed application was received. This would be beneficial in the occasional case where the deregistered charity has successfully reapplied but has incurred a significant tax bill in the time it was not registered. At the moment, the only option for the charity is to appeal to the High Court, which has costs for both the charity and the Board.

The Australian regulator has broader powers when considering applications for registration, including

powers to:

- decline an application for a deregistered organisation if the regulator is not satisfied that the matters that led to the deregistration have been dealt with;
- deregister an organisation for providing false or misleading information in connection with its application for registration; and
- set the date of registration earlier than when a completed application is received.

? What additional powers, if any, should the regulator have when considering applications for registration? Why?

Powers during an investigation

Charities Services can require any person to supply information or documents to assist in its inquiries, but it can be difficult for it to determine whether information provided in response to a notice is complete and accurate.

Charities regulators in Australia, and England and Wales, are able to obtain warrants from the courts to search the premises of a charity during an investigation. Charities Services does not have search powers to gather evidence of offending or serious wrongdoing involving charities.

Charities Services also has limited powers to prevent or contain the loss of charitable resources while an investigation is occurring. For example, the regulator cannot direct a charity to suspend operations, or suspend any person involved in the charity, pending the outcome of an investigation.

Charities regulators in Australia, and England and Wales, have formal powers to direct charities to take (or not take) a certain action, ask a court to make charities do or not do something, and suspend officers of a charity. The Charity Commission in England and Wales can appoint an interim manager to a charity during an inquiry.

? What additional powers, if any, should the regulator have when carrying out an investigation? Why?

Enforcement powers

Currently, the Board's main enforcement powers

to respond to serious wrongdoing or breaches of the Act are to deregister entities and disqualify officers from being involved in other charities. Warning notices can be issued, but there are limited options for intermediate sanctions as alternatives to deregistration in less serious cases of non-compliance.

Australian legislation gives the regulator a range of enforcement powers. For example, the Australian regulator can enter into enforcement undertakings, which are voluntary arrangements with charities about what they must do to meet their obligations. These arrangements can be enforced by a court.

Charities regulators in Australia, and England and Wales, can remove an officer from a charity. In New Zealand, the Board can only disqualify an officer for serious wrongdoing if their charity has been removed from the register (section 31(4)(b)). Where the problem only relates to one individual, it could be useful to be able to remove this person (and ban them from being involved in the charity) but to allow the entity to continue to operate as a registered charity.

- ? What additional enforcement powers, if any, should the regulator have? Why?

The regulator's funding

The functions performed by Charities Services and the Board are funded from a combination of Crown funding and fees paid by charities when filing annual returns. Charities with annual expenditure over \$10,000 pay a fee of \$51. Applying to register as a charity does not incur a fee. The Crown contribution reflects the benefit to the public of a well-regulated charities sector.

Combined funding in 2017/18 totalled \$6.92 million. This figure can be broken down into \$6.05 million Crown funding and \$873,000 (13%) funding from charities fees. These funds are used to support all functions of charities regulation, such as the Board's costs of \$57,000 in 2017/18.

Some commentators in the charities sector consider that because charities provide a public benefit, they should not have to pay fees. If there was no fees revenue, the additional funding would need to come from the Government (or other sources), or services

would need to be reduced. Others have argued that if the sector is expected to contribute to the cost of regulation, there should be a mechanism by which it can influence the prioritisation of the regulator's resources.

Table 5 sets out the last three years of funding.

Table 5: Charities' regulator funding 2015/16-2017/18

Financial year	Crown funding	Funding from fees	Total funding
2017/18	\$6.050 million	\$873,000	\$6.923 million
2016/17	\$5.891 million	\$857,000	\$6.748 million
2015/16	\$5.435 million	\$795,000	\$6.230 million

- ? Should charities pay fees to contribute to the regulation of the sector? Should fees be tiered?
- ? Should a fee attach to registrations, as well as to filing annual returns?

Charities' use of third parties to fundraise

Donations make up \$4 billion of the \$18 billion total annual income of charities. While many charities can solicit donations themselves, others contract a third party fundraiser to solicit donations. For many charities, outsourcing fundraising is the most cost effective option, similar to seeking external legal or accounting advice. It is often cheaper for a charity to use a third-party fundraiser, than to raise the same amount of money itself.

Registered charities must provide information about fundraising costs in their annual financial returns, but do not need to indicate whether fundraising was undertaken in-house or by a third party.

The fundraising sector is self-regulated through the Fundraising Institute of New Zealand and the Public Fundraising Regulatory Association. The organisations work collaboratively to educate their members about fundraising standards and ensure they comply with codes of conduct. Membership of both organisations is voluntary.

All face-to-face fundraisers in New Zealand are members of the Public Fundraising Regulatory



Association. Fundraising Institute of New Zealand members must abide by practice standards set for a range of fundraising methods, such as telemarketing or direct mail.

The Act does not regulate third party fundraisers. Section 28A of the Fair Trading Act 1986 provides for the making of regulations to require information disclosure by third party fundraisers.¹⁷ However, regulations made under this power would only cover the disclosure of third party costs. Comparing the costs of third party and in-house fundraising would be difficult, and implementing regulations could have unintended consequences. For example, it could incentivise charities to fundraise in-house, even if outsourcing fundraising was more efficient. For these reasons, no regulations have been made under section 28A to date.

Surveys of public trust and confidence in charities provide limited evidence of public concern about the

role of third party fundraisers. Some respondents indicated concern about how much money donated to a third party fundraiser would reach the charity.¹⁸

We are interested in hearing donors' views of how charities can use third-party fundraisers without affecting public trust and confidence in the charities sector. For example, the regulator could have a role in educating and informing the public on the role of third party fundraisers, and the reasons charities use their services.

- ? Do you think there is sufficient disclosure of the use of third party fundraisers by charities and the cost? If not, how could greater disclosure be ensured?

¹⁷ Section 28A of the Fair Trading Act 1986 defines a “fundraiser” as a person or organisation who, in business, makes requests for donations for charitable purposes.

¹⁸ Horizon Research “Public Trust and Confidence in Charities” [2014] accessed July 2018 <https://www.charities.govt.nz/assets/Uploads/Resources/Horizon-Research-Public-Trust-and-Confidence-in-Charities-May-2014-.pdf>

Appeal of regulator decisions

Introduction

In any regulatory system, appeals are vital means of holding decision-makers to account. However, as key elements of charities law sit in common law, appeals are especially important. It is therefore only when decisions are appealed to the courts that law (for example the interpretation of 'charitable purpose') can evolve to reflect changes in society. In making registration decisions, the charities regulator applies the law from previous court judgments.

This section seeks your views on how the appeal process is working at the moment, and how to improve it. Specifically, we welcome your feedback on the following.

- What decisions should be subject to an appeal?
- Who should be a party to an appeal?
- What procedures should apply to an appeal?
- What body should decide the appeal?

Current situation

Under section 59 of the Act, a person can appeal a Board decision to the High Court, within 20 working days of the Board's decision. The High Court may confirm, modify, or reverse the decision being appealed. Section 59 only refers to appeals from decisions of the Board. This includes registration and deregistration decisions made by Charities Services under delegation, which means that all registration and deregistration decisions can be appealed.

Section 61, however, provides that in determining an appeal, the High Court may confirm, modify, or reverse the decision of the Board or the chief executive.

The inconsistency between sections 59 and 61 of the Act has led to dispute over whether decisions of the chief executive (delegated to Charities Services) can also be appealed under section 59. The ability to appeal Charities Services' decisions has been a significant point of concern for some charities since the original Charities Bill in 2004. Considering

the Charities Bill in 2004, the Select Committee considered that it should be possible to appeal all decisions of the regulator that adversely impact on a particular organisation.¹⁹

Appeals are not the only means of challenging decisions by Charities Services and the Board. Decisions can also be challenged by judicial review, or by a complaint to the Ombudsman.

An entity affected by a decision may apply for a High Court judicial review of the decision-making process, or the legality or reasonableness of the decision. If successful, the decision is usually referred back for the original decision-maker to reconsider.

The Ombudsman can investigate complaints about the administrative acts and decisions of government agencies.²⁰ Since 2013, the Ombudsman has investigated and made findings on three decisions by Charities Services. These related to two complaints that Charities Services did not investigate and a response by Charities Services under the Official Information Act 1982. None of these three were upheld. Two complaints are currently with the Ombudsman.

Appeals under section 59 are heard according to High Court Rules. Under High Court Rules 20.9 and 20.17, the Board can be represented and heard at the hearing, although it is not the respondent. The Court conducts appeals as re-hearings. This means that it only considers the evidence that was submitted as part of the original application to the Board, unless the Court agrees to the appellant bringing new evidence. This is the standard procedure for an appeal by way of rehearing under High Court Rule 20.18.

Since the charities register was established in 2005, about 56,000 decisions have been made to approve, decline, or deregister organisations.²¹ Of these decisions, we are aware of only 24 that have been appealed to the courts. Of those 24 appeals:

19 Charities Bill 2004 108-2, Select Committee report at 13.

20 Schedule 1, Ombudsmen Act 1975.

21 This number includes voluntary deregistrations, but not registration applications that are withdrawn before a decision is made.

- seven were dismissed;
- six succeeded (with the courts substituting their own decision in four cases, and the courts referring the matter back to the Board to consider in two cases);
- seven were resolved with the consent of the parties without a full hearing; and
- four are ongoing.

Only one of these appeals has gone all the way to the Supreme Court.²²

Nearly all the appeals related to whether the entity was furthering exclusively charitable purposes. These added to the law on how ‘charitable purpose’ is interpreted. A small number of appeals related to other issues, like the backdating of registration.

What are the issues?

Which decisions should be subject to appeal?

The sector’s ongoing concern is that any decision made under the Act – not just registration and deregistration decisions – should be subject to appeal.

Under the Act, Charities Services makes a range of decisions, when exercising functions of the chief executive. A few examples are decisions to:

- treat one or more entities as a single entity (under section 44);
- omit, remove or withhold information from the charities register (under section 25); and
- undertake compliance activities (for example to open an inquiry under section 50).

An ability to appeal a wider range of decisions would provide greater accountability over all regulatory decisions, including relatively minor decisions. On the other hand, allowing appeal of all decisions by Charities Services would have cost implications and would impact on its ability to carry out its functions in a timely and efficient manner. In general, an ability to appeal should be available if a person’s

rights or interests are affected by a decision.

Other challenge routes, for example internal reviews, could be considered for decisions that may not be appropriate for appeals. Internal reviews are used in other regulatory systems. For example, disputed welfare benefits are initially reconsidered through a Work and Income internal review. Internal reviews can correct mistakes, without the cost and formality of an appeal. The downside of internal reviews is that they may not be seen as independent as other challenge routes.

? Which decisions made by Charities Services should be subject to appeal? Why?

? Should the Act provide for internal review of Charities Services decisions?

Who should be a party to appeal of registration decisions?

When hearing an appeal under section 59, High Court Rule 20.9 requires that the decision-maker, in this case the Board, is not named as a respondent. Since there is no opposing party in a charities appeal, the Board may appear to assist the court. The Board cannot advocate for its decision or take an adversarial role. The Board does not have a right of appeal against any decision of the High Court. This limits the appeal process and the development of charitable case law. By contrast, in England and Wales, the Charities Commission is named as the respondent in registration appeals.

The Act also does not require the Attorney-General, as protector of charities, to be named as a party to an appeal or to be served with appeal papers. The court can require the appeal papers to be served on the Attorney-General, and the Attorney-General may apply to join an appeal as a party. However, because there is no requirement to serve appeal papers on the Attorney-General, he or she is not formally alerted to appeals and may not have the opportunity to consider whether to apply to join.

? Should the decision-maker, or anyone else, be a party in appeal cases? Why?

? Should the Attorney-General, as protector of charities, automatically be named as a party to an appeal?

²² *Re Greenpeace of New Zealand Incorporated* [2014] NZSC 105.

Should the court hear new evidence, and how should the appeal be heard?

Appeals under section 59 are heard by the High Court as re-hearings, on the basis of the evidence considered by the original decision-maker. Re-hearings are often used to consider appeals over specific legal or factual errors.

Some stakeholders have raised concerns that opportunities to bring new evidence before the court are limited. This is because the court does not usually hear new evidence during an appeal. If the court does hear new evidence in a re-hearing, it is by affidavit (i.e. written evidence, signed in front of an authorised person).

Some stakeholders are also concerned that there is no testing of evidence orally in re-hearings. This is on top of there having been no oral hearing before the decision-maker that made the original decision.

Some have proposed that appeals be heard *de novo*. This enables an entirely new hearing, with an oral hearing of evidence by the court. On the other hand, *de novo* hearings are generally more expensive and slower than re-hearings. Hearing the matter afresh on appeal may increase the risk of the original decision-making process becoming a 'test run'.

- ? Should it be easier to bring new evidence on appeal?
- ? Should the appeal be heard as a re-hearing (with no oral hearing of evidence), or as a *de novo* hearing (with evidence heard orally)?

Is the time limit for lodging appeals restrictive?

Setting time limits for lodging appeals promotes certainty. Time limits also need to be reasonable, so that the appeal right can be exercised.

Board decisions must be appealed within 20 days from when the decision was made, unless the Court grants an extension. This time-frame is similar to other regimes. For example, appeals to the High Court under the Companies Act must be lodged within 15 working days of the Registrar of Companies' decision. Under the Incorporated

Societies Act, a person has 21 days to appeal to the High Court from the Registrar's decision.

However, some in the sector have raised concerns that the 20 day time limit is particularly problematic for the charities, which are often run by boards of volunteers who need time to discuss the outcome of the decision, decide whether to initiate litigation, and instruct a lawyer. In Australia, decisions must be appealed within 60 days.

- ? What do you consider to be an appropriate time-frame for lodging appeals? Why?

Is the High Court the appropriate body to hear all appeals?

The High Court hears appeals under the Act, and is assisted by following decisions of higher courts (i.e. the Court of Appeal and Supreme Court). Commentators have argued that the cost of High Court proceedings deters entities from appealing decisions. This may explain the relatively small number of appeals heard by the High Court since 2005, relative to the number of registration decisions in that time.

Related to this, some commentators have raised concerns about:

- the risk of costs being awarded against an entity;
- entities being ineligible for civil legal aid (because they are not 'natural persons'); and
- the risk of entities finding themselves 'out-resourced' by the representatives of the regulator assisting the court.

Disputes in other regulatory systems are often decided by a lower level court, tribunal, or authority. A right of appeal to the High Court from a tribunal or appeal authority remains. For example, tax disputes are heard by the Taxation Review Authority. The Taxation Review Authority is less formal, and may end up less costly than the High Court. Taxpayers can appeal the Taxation Review Authority's decision to the High Court.

A person can seek an independent review of an Accident Compensation Corporation decision. Following the review decision, a person can appeal

to the District Court, and subsequently to the High Court (with leave).

- ? What body is most appropriate to hear appeals on registration decisions: the High Court, District Court, or another body?

What other approaches could enable the law on 'charitable purpose' to develop more quickly?

Even though most appeals turn on 'charitable purpose', the number of decisions on appeal each year is small, compared to the number of decisions the Board makes. The small number of court decisions risks the law on 'charitable purpose' becoming static. While overseas cases and cases in related contexts assist, having few court decisions under the Act is an issue. This is because the courts' interpretation of 'charitable purpose' in different cases adds to the law and helps keep the definition relevant.

Few appeals also means limited testing of the Board's decisions by the courts.

- ? What other mechanisms (for example support for test cases) could be used to ensure that case law continues to develop?

Te Ao Māori

He taonga rongonui te aroha ki te tangata
Goodwill towards others is a precious treasure

Introduction

This section seeks your views on issues which primarily affect Māori organisations that register as charities.

Since the Act was passed in 2005, the Māori-Crown partnership has evolved and matured. There have been over fifty Treaty settlements in that time. Modernising the Act is an opportunity to assess how well the Act supports the aspirations of Māori communities, and enables the Crown to fulfil its obligations as a Treaty partner.

Current situation

Ngā mātāpono: guiding Māori concepts of charity

The work of Māori charities not only achieves charitable purposes but is central to maintaining culture, traditions, and sense of identity and kotahitanga (unity and collectivism). While Māori charities are diverse, many will share similar kaupapa (principles and ideas) and tikanga (procedures and customs), and will face similar challenges.

The underlying values that often motivate and guide Māori participation in the charities sector are:

- whanaungatanga – relationship, kinship and family connections which provide a sense of belonging;
- manaakitanga – the process of showing respect, generosity and care for others; and
- kaitiakitanga – the obligation of whānau, hapū and iwi to protect the spiritual wellbeing of the taiao (natural world) and their authority within their area.

In both traditional and urban contexts, each person has a duty of care to whānau, hapū and iwi, and to contribute to maintaining the strength and wellness of that community. Mahi aroha (unpaid work to fulfil cultural obligations) is a term akin to volunteering, describing activity performed out of sympathy and caring for others, rather than for financial or personal reward.

Case study: Manukorihi Pā Reserve Trust - example of an iwi-based charity

Manukorihi Pā Reserve is a historical Pā in Waitara, Taranaki rich in history and still today a focal point for the wider community. The Pā Reserve features a number of significant buildings including Te Ikaroa a Maui, a carved wharenui, crafted by many locals and people from all over New Zealand.

Manukorihi Pā Reserve Trust consists of twelve trustees representing the 6 hapū of Te Atiawa and 6 beneficial landowners to the reserve. One of the Trust's charitable purposes is to educate visiting groups, including early childhood centres, kohanga reo, kura, schools, and tertiary institutions about the unique history of the reserve.

The Trust promotes whanaungatanga by actively linking whānau of Te Atiawa Whānui through events such as the annual celebration of the legacy of Sir Maui Pōmare. This celebration attracts hundreds of people each year from around Taranaki and the country. The Trust also maintains Ōwae Marae as a cultural gathering and meeting place for iwi, hapū, whānau, and the wider community. The Trust is guided by values and traditions handed down by tūpuna, thus upholding the principles of Mana Tangata, Mana Whenua, Manaaki Tangata and other Tikanga Māori appropriate to the Reserve.

Types of Māori charity

In this document, the term 'Māori charity' means a charity that has a Māori kaupapa or is run by Māori, primarily for the benefit of Māori.

Māori charities include:

- tangata whenua governance organisations which manage the affairs of hapū, iwi and marae; and
- organisations focused on specific charitable purposes relating to Māori, such as Te Rōpū Wāhine Māori Toko i te Ora (Māori Women's Welfare League), Te Kōhanga Reo National Trust Board (aimed at maintaining

and strengthening Māori language and philosophies) and Māori Television Services.

Like other charities, Māori charities use a range of legal structures including unincorporated trusts, charitable trusts, incorporated societies, and companies. However, some legal structures are unique to Māori charities, including:

- *marae*: Maintenance and administration of marae on Māori reservations is a charitable purpose under the Act (section 5(2)(b)). Most marae also have other charitable purposes, such as community facilities, education or social services.
- *iwi settlement organisations*: These include post settlement governance entities (PSGEs) and mandated iwi organisations (MIOs).
 - PSGEs receive cash and other assets from the Crown, on behalf of claimant groups, as redress for historical breaches of the Treaty of Waitangi. Generally the Crown has not settled assets on charitable trusts, but many PSGEs have later established both charitable and commercial arms.
 - MIOs are iwi organisations established under the Māori Fisheries Act 2004 to

receive allocated fisheries assets. MIOs must establish asset holding companies. Some MIOs are registered as charities.

- *Māori Trust Boards*: Established under the Māori Trust Board Act 1955, these boards administer assets for their beneficiaries, and some are registered charities.
- *Te Ture Whenua Māori Act trusts*: The Māori Land Court can constitute a range of trusts to manage Māori land, some of which are registered charities.

The Māori charities sector

We estimate there are about 1000 Māori charities, with most involved in education, training and research, arts, culture, and heritage, health, social services and religion. Around 200 to 300 marae are registered as charities. Māori charities are less than 5% of the total number of charities.

Over 60% of Māori charities have annual expenditure under \$125,000. However, some iwi settlement organisations with large asset holdings are registered charities. As at April 2018, Māori charities held around \$6 billion in total assets, with \$1.5 billion in total annual income, and total expenditure of \$1.2 billion.

What are the issues?

Māori charities share many of the issues and opportunities covered elsewhere in this document. Below are some issues particularly relevant to Māori charities. We would like to hear from you whether there are other issues we have not covered.

- ? What is working for Māori charities under the Act? What is not?
- ? Are there any issues under the Act that impact Māori charities differently to other charities?

Charitable status may limit the use of Treaty settlement assets by iwi entities

Treaty settlements have enabled iwi to support their people in ways such as providing financial support, saving schemes, housing, health and social services, and improving marae.

Where settlement assets are held by an iwi settlement organisation or subsidiary entity that



is a registered charity, those assets can only be used for charitable purposes. This can limit how iwi settlement organisations use their funds to benefit their members. Some have argued that the restrictions on charities can act as a ‘straitjacket’ which prevents initiatives to promote iwi self-determination, such as universal cash distributions, or housing, employment, and economic development programmes. If an iwi settlement organisation wishes to deregister a charity, so it can apply funds to purposes that benefit the iwi or hapū but are not charitable under the law, it may risk incurring a deregistration tax on its assets.²³

- ? Are you aware of cases where an iwi settlement organisation has limited its activity because of its charitable status?
- ? Should the Act be more flexible for iwi settlement organisations that are charities? If so, how?

Challenges with reporting requirements

Similar to many small charities, marae can struggle to meet reporting requirements. While most marae are complying with the new reporting standards, some are finding it difficult.

We understand there may be confusion about how the requirement to record revenue from members should be interpreted in the context of marae activities and tikanga Māori.

- ? Are you aware of any particular problems with the reporting requirements for Māori charities?

²³ However, we note Section HR 12 of the Income Tax Act 2007 includes carve out provisions for assets received from the Crown to settle a Treaty of Waitangi claim or in accordance with the Māori Fisheries Act 2004.

Business

Introduction

This section seeks your views on how to manage risks around charities that operate businesses to generate income for charitable purposes.

All charities need sustainable sources of finance to carry out their work. Since the passing of the Act in 2005, information from Statistics New Zealand indicates that charities overall are relying increasingly on income from trading goods and services.²⁴

The Act does not contain any explicit provision for charities with business activities but there are related provisions. Section 13 states that a charity cannot be carried on for the private profit of any individual. According to case law, charities can operate a business so long as any profit is ultimately applied to exclusively charitable purposes.

In recent years, it has become common to refer to charities with significant trading as social enterprises. The term ‘social enterprise’ is not defined in legislation, but it generally refers to organisations that get most of their income from trading, and apply the majority of profits to pursuing social or environmental impacts. Many social enterprises are registered charities. Because of section 13, a social enterprise that provides private profit to an individual cannot register as a charity.

The regulatory framework should enable charities to raise funds to support their work, while providing certainty that charities are only undertaking business activities to further charitable purposes.

Current situation

Charities with unrelated businesses

This chapter is particularly concerned with charities with ‘unrelated businesses’ where the service or product does not directly contribute to a charitable purpose. These take many forms, such as op shops, food and drink retailers, hotels, and trucking

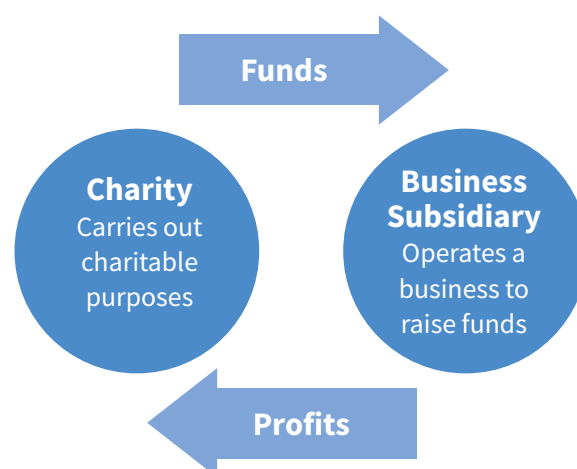
companies. This differs from charities with trading operations related to their charitable purpose, such as a medical clinic providing health services to promote public health.

We do not know exactly how many charities carry out unrelated business activities. However, approximately 900 companies are registered charities. There are 6,700 charities that report costs of trading. This number includes both charities with unrelated businesses and charities with trading operations related to their charitable purpose. That is about a quarter of the total number of registered charities. They hold \$22 billion in total assets and receive \$2.9 billion in income from trading and \$7 billion in total gross income in 2017.²⁵

Structure of charities with unrelated businesses

Some charities are standalone businesses that solely raise funds for charitable purposes. Some charities choose not to run standalone businesses. Instead, they establish subsidiaries to operate their businesses, as illustrated in Figure 4. The charity may fund the set-up of the business subsidiary, and the business returns profits to the parent charity. A business subsidiary of a charity may or may not be registered as a charity itself. Currently, a business subsidiary does not need to be separately registered to access tax benefits although there are proposals before Parliament to change this.²⁶

Figure 4: Relationship between a charity and its business subsidiary



²⁴ Statistic New Zealand (2016). Non-profit Institutions Satellite Account: 2013.

²⁵ Information sourced from annual returns provided to Charities Services.

²⁶ Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill 2018 (72-1).

The law on charities and unrelated businesses

New Zealand courts have long held that a charity can undertake business activities unrelated to its charitable purposes. A charity may carry on any business, buy and sell, employ staff, accumulate funds, and engage in any other commercial activities. The key test is whether income from those business activities is ultimately applied to charitable purposes.²⁷

Currently, Charities Services requires that for an organisation with an unrelated business to register as a charity, it must show that:

- the business is capable of making a profit to go to charitable purposes; and
- the organisation does not provide any resources to its business operations at less than market rates.

To assess registration applications by organisations

with unrelated businesses, Charities Services reviews the organisation's rules and considers information on its activities. This information may include financial statements and business plans, and any independent professional advice the charity has received.

Example A: An unrelated business successfully generates income for charitable purposes

'Positive Energy' is a limited company which supplies power to New Zealand businesses and communities. It is owned by a community trust that distributes grants for charitable purposes. Both Positive Energy and the community trust are registered as charities.

Positive Energy owns total assets worth \$200 million, mostly its power stations and computer systems. It generates a net surplus each year of around \$7 million. Of that, about \$5 million per year is distributed for charitable purposes through its owner, the community trust.

²⁷ *Auckland Medical Aid Trust v CIR* [1979] 1 NZLR 382 at 387. See also *CIR v Carey's (Petone and Miramar) Ltd* [1963] NZLR 450; *Calder Construction Co Ltd v CIR* [1963] NZLR 921; *CIR v NTN Bearing-Saeco (NZ) Ltd* (1986) 8 NZTC 5,039.



Duties of officers of charities undertaking business activities

The officers of a charity that undertakes business activities will often have other legal duties depending on the charity's legal structure. For example:

- trustees of a trust have duties to avoid conflicts of interest, invest prudently and not profit from being a trustee;
- officers of an incorporated society must ensure the society's activities are not carried on recklessly or in a way that creates substantial risk of serious loss to the society's creditors; and
- directors of a company must act in good faith and in what they believe to be the best interests of the company.

Charities and business in other countries

In respect of business activities, the New Zealand charities regime is comparatively liberal. Other countries, including Canada, the United Kingdom, the Republic of Ireland, and the United States, generally do not allow unrelated businesses to register as charities.

In Canada, for example, a charity can only carry on a business if it is a 'related business'. That is, a business that is either run substantially by volunteers, or is linked to a charity's purpose and subordinate to that purpose. A charity can establish a subsidiary company to generate finance for its charitable purposes, but the subsidiary cannot register as a charity.

In England and Wales, charities can only engage in an unrelated business if the business involves no significant risk to the charity's assets. If there is significant risk, the charity must establish a business subsidiary that is not a registered charity, and must do so in a way that protects the charity's assets.

What are the issues?

Are the registration requirements for unrelated businesses appropriate?

Charities Services' approach to unrelated businesses, derived from the Act and case law, is questioned by some stakeholders. It may be difficult for a charity with an unrelated business to meet

the requirements for registration under Charities Services' approach, especially for a small start-up aiming to raise funds for charitable purposes. For example, it may be difficult to demonstrate the business's ability to make a profit in the early stages (see example B).

Example B: A start-up business struggling to generate profits for its parent charity

A trust and a subsidiary company apply to register as a charity. The trust's main purpose is to provide scholarships for tertiary students studying computer science.

The company was started five years ago to raise funds by selling software products. The trust provided \$300,000 in loans to the company, and raised \$100,000 funding from a public campaign. That money has supported the salaries of a team developing software products as well as for marketing, computer equipment, and office rental.

The company started selling its software four years ago but has yet to make a profit. It hopes to make a profit in the next three years - though sales have not increased since the first year. It says it needs more funds for software development and marketing to increase sales. The trust plans to make further loans to the company. It has provided \$10,000 in scholarships since it was founded.

The regulator must decide whether the trust and company are furthering charitable purposes through support for the software business. It will look for evidence that shows the company will be able to generate profits to fund the trust's charitable purposes.

- ❓ What should be the registration requirements for unrelated businesses?

Reporting requirements for charitable businesses

Some charities undertaking business activities have developed complex structures with a large number of subsidiaries. These structures may include business subsidiaries which are for-profit or involved

in partnerships with for-profit entities.

The Act provides some tools for the regulator and the public to monitor the activities of those subsidiaries even if they are not registered. For example, it enables the regulator to require information from non-charities when investigating a breach of the Act.

The reporting standards require charities to provide information on all organisations they control in consolidated financial statements, even where the business subsidiary is not registered. Consolidated financial statements present information about a charity and the organisations it controls as if it were a single entity.

In some cases, consolidation can reduce transparency. Consolidated financial statements may not contain all the information needed to fully assess the financial well-being of business subsidiaries of a charitable group. Consolidation may also obscure transactions between the charitable arm and business arm of a charitable group. It may not be clear if transactions between the charitable and the business arms are furthering a charitable purpose.

Conversely, where a charity-owned business is not registered, consolidation does provide some

valuable information on the business subsidiary that may not otherwise be reported.

Some charities may wish to withhold financial information on their business subsidiaries from the charities register for commercial sensitivity reasons. In particular, where the business subsidiary is not a registered charity and does not receive any tax benefits.

- ? How should charities report on their business operations and business subsidiaries?
- ? Should charities be required to report separately on business subsidiaries that they control that are not registered charities? If so, why?

Charitable funds may be put at risk

Providing support to a business may be a good use of charitable funds, if the business has the potential to provide sustainable income for the charity. However, if the business is not successful, it may deflect the charity's funds away from its charitable purpose. If the business closes, the charity may not get back the funds it used to support the business, particularly if the business has borrowed money or has other creditors (see example C).

Members of the public who donate to charities expect donations to go to charitable purposes. If



too many charities take on too much business risk, this could ultimately start to erode public trust and confidence in the charities sector.

Example C: Charitable funds lost through business activities

The Southern Cross Charitable Trust was deregistered as a charity for gross mismanagement and advancing a non-charitable purpose to provide private benefit to related parties.

The Trust was formed in 1993 with purposes to provide education and support youth-at-risk and was registered under the Act in 2008. Previously, the Trust had set up and provided substantial funds for the Kiwi Can programme.

The Trust raised funds by charging interest on loans to building projects. For each project, the Trust established a trust and a company, each run by one of the trustees. The Trust established a total of 45 trusts and companies in this manner.

Huge amounts of money went through the Trust, with very little applied to charitable purposes. Between 2005 and 2010, the Trust received an estimated \$30 million from the building projects. Around \$25 million of this was loaned back to related entities.

During the time it was registered, the Trust provided \$11,392 in donations to registered charities.

Approximately \$34.5 million remained outstanding in loans and unpaid interest at the time of deregistration.

In England and Wales, charities are not permitted to run businesses where there is significant risk to charitable assets. However, introducing a significant risk test in New Zealand could make it more difficult for some charities to raise funds.

As discussed above, most charity officers will already be bound by other duties under the law

depending on the charity's legal structure. However, governance standards, discussed in the chapter on the Obligations of charities, are another way to mitigate the potential risk to charitable funds. Standards could include guidance for charities when making decisions on business activities.

This guidance could also respond to wider concerns of charities and investment. In particular, concerns about charities that wish to invest in social enterprises that provide lower rates of return than other investment options.

? What, if any, restrictions (such as the 'significant risk' test in England and Wales) should exist on the level of risk for charities undertaking business activities?

Charitable funds may provide private profit to individuals

'Related party transactions' are transfers of money, goods or services between a charity and people closely associated with (or able to influence) the charity. Charities commonly rely on services from related parties such as officeholders and members of the governing group, and often it is reasonable for payments to be made in return. Charities are required to include any related party transactions in their financial statements.

However, related party transactions can create conflicts of interest. Officers might not make decisions in the best interest of the charity, for example. They may receive higher than market rate salaries or interest free loans. In these situations, income from business risks being used for private gain.

The Act does not indicate how to manage conflicts of interest, but Charities Services may require a charity to take reasonable steps to address conflicts, such as having a robust conflict of interest policy and rules expressly preventing officers from acting when conflicted.

Governance standards could promote duties which limit risks around related party transactions.

? What should be the requirements of charities to manage conflicts of interest when undertaking business activities?

Advocacy

Introduction

This chapter seeks views on the extent to which charities can engage in advocacy. By ‘advocacy’, we mean working to change, or stop changes, to law and government policy. It also includes promoting points of view on issues in society.²⁸

Advocating for causes can be a legitimate and important way for charities to achieve their charitable purposes. Charities play a crucial part in the development of policies and laws in a democratic and participative society.

From time to time advocacy by charities attracts public concern.²⁹ There is therefore some risk that too much of the ‘wrong kind’ of advocacy could erode public trust and confidence in charities. Conversely, some charities are concerned that they can't advocate at all, or they limit their advocacy, because they may lose their charitable status.

The Act offers little guidance on when and how much charities can advocate for causes. Instead, the key precedents are in common law. Some decisions relating to advocacy have been tested in court, but as few decisions are appealed, the law has been relatively slow to develop and it is complex.

Greater clarity on the issue would benefit charities, the regulator, and the public.

Current situation

In New Zealand, charities may not engage in partisan political activity, such as promoting or opposing a political party or a candidate for political office. The same is true in nearly every comparable country.

In terms of advocacy for a change in law or policy, the Act states that an advocacy purpose is permitted if it is ancillary to that charity's main purpose (section 5(3)). This reflected the common law on advocacy purposes at the time the Act was passed.

However, the Supreme Court's 2014 *Re Greenpeace* decision held that an advocacy purpose is charitable if it advances a public benefit in a way similar to purposes recognised as charitable by the courts. For example, the promotion of human rights and the protection of the environment.

So in *Re Greenpeace* and subsequent decisions, the courts have ruled that both the organisation's end goal and the particular policies and views it promotes must provide a public benefit. When deciding if an organisation is charitable, the decision-maker must consider not only the organisation's end goal, but also the particular policies and views it promotes and how it promotes them.

How the Charities Registration Board has applied the *Re Greenpeace* decision

The Board has applied the Supreme Court's test on advocacy in nine published decisions since *Re Greenpeace*. The Board has decided that some charities with advocacy purposes meet the Supreme Court test but has decided that other advocacy organisations do not.

In four of these decisions, the Board decided that organisations with advocacy as a main purpose qualified for registration as a charity. Two of these decisions are described in the decision summaries below (Save Animals from Exploitation and Clevedon Village Trust). In these decisions, the Board held that both the charities' end goals and the points of view they advocate for provide a public benefit similar to charitable purposes in the common law.

In the other five decisions, the Board deregistered (or declined registration to) organisations which had advocacy as a main purpose, including Family First (summary of the High Court decision below). In these decisions, the Board accepted that some of the organisations have broad end goals that are charitable, for example the protection of the environment. However, when the Board looked at

²⁸ The focus here is on advocacy for causes and political purposes, rather than personal advocacy for people unable to speak for themselves (which is a commonly recognised as acceptable for charities).

²⁹ For example: <https://www.change.org/p/chief-executive-of-new-zealand-charities-trevor-garrett-revoke-safe-s-status-as-an-official-new-zealand-charity>; and <https://www.tvnz.co.nz/one-news/new-zealand/petition-calls-sensible-sentencing-trusts-charitable-status-reassessed-after-controversial-facebook-post>

the particular points of view that the organisations advocated for to support their end goal, the Board decided that there was not clear evidence of public benefit (see for example the decision summary on *Kiwis Against Seabed Mining*).

Board decision summary: Clevedon Village Trust³⁰

Clevedon Village Trust was set up to develop a master plan for Clevedon District in Auckland and to encourage local authorities and property developers to adopt the plan. The Trust applied for registration as a charity in 2016. The Board noted the Trust's purposes included advocacy for the specific proposals in the plan.

The courts have long recognised promotion of public amenities and heritage values as charitable. The Trust was able to demonstrate that the plan was being produced by experts in architecture, landscape and urban design, with widespread community engagement, and was focused on sustainable development. The Trust also showed evidence of the heritage values of Clevedon Village and how the plan would promote this heritage.

The Board considered that this evidence demonstrated that there was a public benefit in the Trust's purposes to advocate for the adoption of the master plan for Clevedon. The Board approved the Trust's application for registration.

Board decision summary: Save Animals From Exploitation³¹

In 2015, Charities Services received a petition from members of the public to remove Save Animals From Exploitation (SAFE) from the register because its purposes were claimed to not be charitable. In response, the Board reviewed SAFE's registration.

The review found that SAFE's overall end goal was charitable: the promotion of animal welfare. The Board considered that most of SAFE's advocacy provides a public benefit.

SAFE undertakes public campaigns to promote public awareness of how humans cause animal suffering and to encourage people to adopt lifestyle choices such as vegetarianism and veganism. SAFE's campaigns also draw the Government's attention to breaches of animal welfare legislation.

The Board considered that these campaigns advanced a charitable purpose because they provide a public benefit similar to previous charity law cases. The courts have long recognised that purposes to promote vegetarianism and the enforcement of animal welfare laws can be charitable.

The Board did not form a view on SAFE's other campaigns advocating for changes to animal welfare laws and regulation. For example, SAFE's campaign for a ban on rodeos. However, the Board considered this advocacy was only ancillary to SAFE's charitable purposes.

The Board directed that SAFE remain on the charities register.

³⁰ The Board *Registration decision: Clevedon Village Trust (CLE53288)* (10 May 2017) <https://www.charities.govt.nz/assets/Uploads/Registration-Decision-Clevedon-Village-Trust.pdf>

³¹ The Board *Review decision: Save Animals From Exploitation (CC40428)* (19 April 2018). <https://www.charities.govt.nz/assets/Uploads/SAFE-Review.pdf>

Board decision summary: Kiwis Against Seabed Mining³²

Kiwis Against Seabed Mining (the Society) applied for registration as a charity in 2014. Its purpose is to inform and educate communities on the impacts of seabed mining.

The Board considered that the Society's end goal – the protection of the environment – is charitable. It also accepted that some of the Society's advocacy advances a charitable purpose, in particular where it provides expertise and objective evidence to assist resource management decisions.

However, the Board did not consider the Society advanced a charitable purpose in all the points of view it advocated. In particular, the Society advocates for a moratorium on all seabed mining until the environmental impacts can be identified and prevented. The Board considered it was not in a position to determine a public benefit in this point of view taking into account all the consequences of a moratorium on seabed mining and the competing views and arguments on the issue.

The Board declined the Society's application for registration.

purposes and the Board was wrong to decide that cryonics research was not a useful subject of study.

The High Court held, in line with *Re Greenpeace*, that the decision-maker should begin by asking if the stated purposes in the rules document are charitable or not, and should then consider whether the organisation's activities (for instance, advocacy activities) support its charitable purposes.

The courts' approach to advocacy following the Supreme Court decision

The courts have considered three registration or deregistration decisions of the Charities Registration Board under appeal since *Re Greenpeace*. Two decisions related to Family First. We summarise the most recent decision in 2018 below.

In 2016, the High Court reversed a Board decision to decline registration for two foundations with purposes to fund cryonics research.³³ The High Court held that the foundations had charitable education

³² The Board *Registration decision: Kiwis Against Seabed Mining Incorporated* (KIW49965) (15 December 2016). <https://www.charities.govt.nz/assets/Uploads/Kiwis-Against-Seabed-Mining-Incorporated.pdf>

³³ *Re the Foundation for Anti-Aging Research and the Foundation for Reversal of Solid State Hypothermia v Charities Registration Board* [2016] NZHC 2328.

Court decision: Family First³⁴

On 15 April 2013, the Board deregistered Family First. Family First appealed the decision but it and the Board agreed to defer the appeal until after the Supreme Court delivered its judgment in *Re Greenpeace*.

In 2015, the High Court directed the Board to reconsider its deregistration of Family First. The Board again decided to deregister Family First in 2017. Family First appealed the Board's decision but in August 2018 the High Court dismissed the appeal.

Family First's primary purpose was determined to be promotion of the 'traditional family unit', consisting of the permanent union of a man and woman and their children. To achieve this, Family First advocates for removing disincentives to marriage, the abolition of no fault divorce, and limiting marriage to male-female unions. Its advocacy includes support for 'light smacking', and views on abortion, euthanasia and censorship.

The Court held that promoting the traditional family unit (as defined by Family First) was not beneficial to the community in a way recognised by law. In particular, it was inconsistent with human rights law which prohibits discrimination on the basis of marital status. The changes to the law promoted by Family First would also cause costs to families and society. For example, the legal changes to divorce advocated by Family First would make divorce more difficult and costly.

Family First is appealing the High Court decision to the Court of the Appeal.

Greenpeace, the law on charities and advocacy is complex and confusing for many charities and members of the public.

In particular, the Supreme Court's decision provides little guidance on how to assess the public benefit of advocacy by an organisation. The Supreme Court itself noted it will be difficult for an organisation to show public benefit in the promotion of points of view as readily as those who can show 'tangible utility in the good they do'. Few decisions on charities and advocacy have come before the courts since *Re Greenpeace*.

Given this uncertainty and the risk of losing charitable status, some commentators are concerned that charities limit their advocacy. This may have the consequence of reducing charities effectiveness in furthering their charitable purposes.

Charities Services publishes guidance on its approach to charities and advocacy, taking into account feedback from charities sector representatives. More engagement with the charities sector on advocacy may assist in increasing understanding of when charities can advocate for their causes and points of view.

? Are you aware of charities that are reluctant to advocate for changes to law and policy that would further their charitable purposes?

The law is difficult for the regulator to apply

The current law also creates difficulty for the Board in assessing the public benefit of an organisation's advocacy. The approach in *Re Greenpeace* requires the Board to assess the public benefit of both the *ends* and the *particular points of view* promoted by organisations. However, there is little detail of how the regulator should assess the 'public benefit' in charities that advocate for causes.

In its 2015 Family First decision, the High Court said that the Board needs to examine whether a charity's advocacy is 'objectively directed' at promoting a charitable purpose. This is not always clear, particularly where a group is advocating on complex or contested issues. Some advocacy may benefit some parts of the public and not others, for example.

What are the issues?**The law is difficult for charities and the public to understand**

Even following the Supreme Court decision in *Re*

34 *Re Family First New Zealand* [2018] NZHC 2273 <https://www.charities.govt.nz/assets/Uploads/Family-First-New-Zealand2.pdf>

Not only is the law difficult for the Board to apply, but some charities and commentators have argued that the application of the law is too narrow and inhibits the independent voice and expertise of the charities sector (see questions below).

Some measures to strengthen the regulator's decision-making, described in the Role of the regulator chapter, could help the regulator when deciding public benefit in advocacy cases. In particular, rules of evidence for registration decisions could improve how organisations with advocacy purposes are assessed.

Making it easier for charities to appeal decisions may help charity law on advocacy to develop. More court decisions on advocacy could clarify how an organisation shows that its advocacy provides a public benefit and test the regulator's approach (see the Appeals chapter).

As discussed in the regulator chapter, the Australian regulator receives advice and recommendations from a Ministerially-appointed advisory board. Advocacy is an example of a situation where an advisory board could provide independent expert advice to assist the regulator in its decision-making.

? How should the public benefit of organisations that advocate for their causes be assessed?

? What would an advisory board (as in Australia) add to the regulator's decision-making on the registration of charities that advocate? Are there any other ways to help improve the regulator's decision-making here?

The law on charities and advocacy may be too restrictive

In Australia, the 'charitable purpose' definition includes promoting or opposing a change to any matter established by law, policy or practice if it furthers or aids a charitable purpose.³⁵ On the other hand, there are 'disqualifying purposes' under the law which a registered charity cannot have.³⁶ For example, promoting or opposing a political party or a candidate for political office.

Adopting this approach in New Zealand legislation could broaden the range of advocacy that is acceptable for charities, and could be a simpler test to understand. However, the Australian approach has not solved all problems for charities and advocacy. There is still ambiguity in the Australian Act about what is a 'disqualifying purpose'. Guidance is still needed to support charities engaging in advocacy so that they can comply with the law.

? Would you like to see greater freedom for charities to advocate for policy or law change? What would be the benefits? What would be the risks?

? Should there be limits on advocacy by charities? If so, what should these be?

³⁵ *Charities Act 2013* (Cth) s 12(1).

³⁶ *Charities Act 2013* (Cth) s 11.

Appendix: Questions to submit on

Vision and policy principles - page 16

- ? What are the key challenges facing the charities sector over the next ten years?
- ? What are the key opportunities facing the charities sector over the next ten years?
- ? What is the role of government in achieving this vision?
- ? Do you agree with the vision and policy principles described here?
- ? Would you remove or change any part of the vision and policy principles?

The purpose of the Act - page 17

- ? Do you agree with either of the two possibilities for additional purposes?
- ? Are there any additional purposes you think should be added to section 3?

Obligations of charities - page 18

- ? Why did your organisation register as a charity? For example, was the main reason public recognition, or to meet a funder's requirements, or tax benefits?
- ? What benefits does your charity experience from being registered under the Act?

Reporting requirements

- ? Is more support required for charities to meet their obligations? If so, what type of support is needed?
- ? Should reporting requirements for small charities be reduced? If so, what would be the benefits? What would be the risks?

Definition of an officer and qualifications

- ? Should the definition of 'officer' be broadened for trusts that are registered charities?

- ? Should someone with serious convictions be disqualified from being an officer of charity? If so, what kinds of convictions?

Accumulation of funds

- ? Should charities be required to be more transparent about their strategy for accumulating funds and spending funds on charitable purposes (for example, through a reserves policy)? Why? Why not?
- ? Should certain kinds of charities be required to distribute a certain portion of their funds each year, like in Australia?

Governance standards

- ? Do you think governance standards could help charities to be more effective? Why?
- ? Do you think the Australian governance standards could be adapted to work in New Zealand?

Alignment of other legislation

- ? Should the Charities Registration Board continue to be bound to follow charitable purpose interpretations made by the Commissioner of Inland Revenue?

Role of the regulator - page 25

Strengthening connections between the regulator and the charities sector

- ? How could the regulator be made more accessible to charities? For example, what would consultation requirements or an advisory board achieve?
- ? Are the current accountability mechanisms for the Charities Registration Board and Charities Services (described above) adequate? How could accountability be improved?

Strengthening registration decision-making

- ? How could rules and processes for registration decision-making be improved?

Perceptions of independence

- ? What is driving concerns over the independence

of decision-making by the regulator?

- ? Would alternate structures or governance arrangements address any perceived lack of independence in decision-making?

Improving the charities register

- ? How could the register be improved?

Powers when considering applications for registration, powers during an investigation, and enforcement powers

- ? What additional powers, if any, should the regulator have when considering applications for registration? Why?
- ? What additional powers, if any, should the regulator have when carrying out an investigation? Why?
- ? What additional enforcement powers, if any, should the regulator have? Why?

The regulator's funding

- ? Should charities pay fees to contribute to the regulation of the sector? Should fees be tiered?
- ? Should a fee attach to registrations, as well as to filing annual returns?

Charities' use of third parties to fundraise

- ? Do you think there is sufficient disclosure of the use of third party fundraisers by charities and the cost? If not, how could greater disclosure be ensured?

Appeal of regulator decisions - page 34

Decisions subject to appeal

- ? Which decisions made by Charities Services should be subject to appeal? Why?
- ? Should the Act provide for internal review of Charities Services decisions?

Party to appeals

- ? Should the decision-maker, or anyone else, be a party in appeal cases? Why?
- ? Should the Attorney-General, as protector of

charities, automatically be named as a party to an appeal?

Hearing new evidence, and how to hear the appeal

- ? Should it be easier to bring new evidence on appeal?
- ? Should the appeal be heard as a re-hearing (with no oral hearing of evidence), or as a de novo hearing (with evidence heard orally)?

Time limit for lodging appeals, and appropriate body to hear appeals

- ? What do you consider to be an appropriate time-frame for lodging appeals? Why?
- ? What body is most appropriate to hear appeals on registration decisions: the High Court, District Court, or another body?

Other approaches to enable the law on 'charitable purpose' to develop

- ? What other mechanisms (for example support for test cases) could be used to ensure that case law continues to develop?

Te Ao Māori - page 38

- ? What is working for Māori charities under the Act? What is not?
- ? Are there any issues under the Act that impact Māori charities differently to other charities?
- ? Are you aware of cases where an iwi settlement organisation has limited its activity because of its charitable status?
- ? Should the Act be more flexible for iwi settlement organisations that are charities? If so, how?
- ? Are you aware of any particular problems with the reporting requirements for Māori charities?

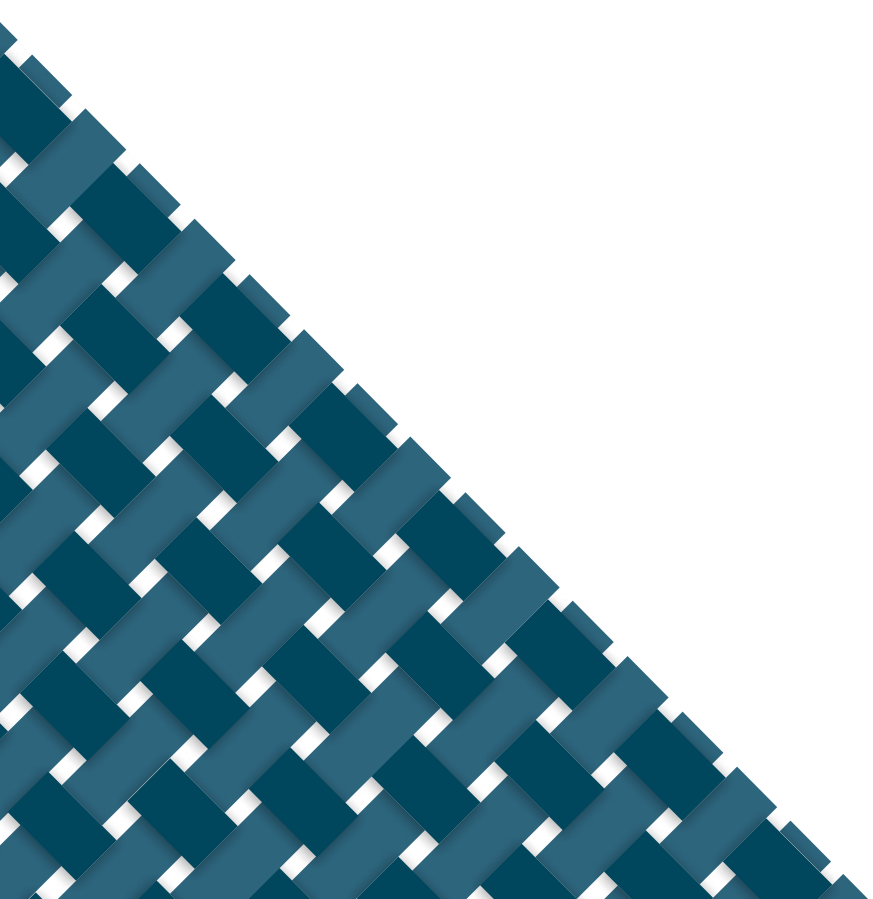
Business - page 41

- ? What should be the registration requirements for unrelated businesses?

- ? How should charities report on their business operations and business subsidiaries?
- ? Should charities be required to report separately on business subsidiaries that they control that are not registered charities? If so, why?
- ? What, if any, restrictions (such as the 'significant risk' test in England and Wales) should exist on the level of risk for charities undertaking business activities?
- ? What should be the requirements of charities to manage conflicts of interest when undertaking business activities?

Advocacy - page 46

- ? Are you aware of charities that are reluctant to advocate for changes to law and policy that would further their charitable purposes? Why are they reluctant to do so?
- ? How should the public benefit of organisations that advocate for their causes be assessed?
- ? What would an advisory board (as in Australia) add to the regulator's decision-making on the registration of charities that advocate? Are there any other ways to help improve the regulator's decision-making?
- ? Would you like to see greater freedom for charities to advocate for policy or law change? What would be the benefits? What would be the risks?
- ? Should there be limits on advocacy by charities? If so, what should these be?



Te Tari Taiwhenua
Internal Affairs

New Zealand Government



EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

20 April 2019

Charities Act Team
Policy Group
Department of Internal Affairs
PO Box 805
WELLINGTON 6140

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Dear Sir/Madam

Department of Internal Affairs Discussion Document: *Modernising the Charities Act 2005*

Introduction

1. The External Reporting Board (XRB) is pleased to have the opportunity to comment on the Ministry's Discussion document: *Modernising the Charities Act 2005* (Discussion document). We have responded to selected questions from the Discussion document as our interest and mandate is limited to financial reporting.

XRB's role, responsibilities and focus

2. The XRB is an independent Crown Entity responsible for financial reporting strategy and the development and issue of accounting, and auditing and assurance, standards, in New Zealand.
3. Under the Financial Reporting Act 2013, the XRB issues accounting standards for all entities that are required, or opt, under law to prepare financial statements that comply with accounting standards issued by the XRB. From 1 April 2015, XRB accounting standards were required to be applied by all registered charities.
4. The law determines **who** is required to report, for example, registered charities. The XRB is responsible for **what** these entities are required to report, being XRB standards. Charities Services monitors and enforces compliance with XRB standards by registered charities.
5. 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 in a position to require an entity to prepare reports tailored to their particular information needs. For registered charities, these users are primarily grantors, donors (including members of the public) and service recipients.

6. Our submission is structured as follows:
 - (a) Summary of the XRB's main points; and
 - (b) Responses to selected questions from the Discussion document.
7. We have included, as an Appendix, background information on the development of XRB Simple Format Reporting Requirements.

Summary of the XRB's main points

8. The XRB is, in principle, opposed to the establishment of a new 'micro entity' tier for charities with less than \$10,000 operating expenditure and the suggestion that such entities should not be required to comply with current XRB accounting standards. Non-compliance on its own should not drive changes to the statutory reporting requirements.
9. These small charities are currently required to comply with the Tier 4 Simple Format Reporting Standards¹ as issued by the XRB. These reporting requirements have been specifically designed for smaller charitable entities and written in simple language for non-accountants (such as volunteers).
10. We consider that the current Tier 4 Simple Format Reporting Requirements continue to provide appropriate reporting requirements for the approximately 39% of registered charities with annual expenditure less than \$10,000.
11. We note that Cabinet rules would require the Department of Internal Affairs to undertake a full regulatory impact analysis on any changes to the reporting requirements. If changes to the reporting requirements is the outcome of this review we request that the XRB be consulted further in relation to that process as the Crown body with statutory responsibilities in this area.
12. Both the XRB and Charities Services from 2012 have been consistent in their messaging that all registered charities regardless of size have some minimum statutory financial reporting obligations. This messaging reflects the Government view that all registered charities are accountable to the donating public and must report in a transparent manner to engender public trust and confidence in the charitable sector. Any change that provides an exemption from complying with XRB reporting standards for smaller entities will significantly weaken this message, leading to a likely decrease in the public's confidence across the entire charities sector.
13. The new reporting requirements for registered charities came into effect on 1 April 2015 following a review² of the quality of charities' annual reporting in 2009 by the then Ministry of Economic Development (MED)³. The primary basis for MBIE introducing new statutory reporting requirements was the view that all registered charities are accountable to the public

¹ *Tier 4: Public Benefit Entity Simple Format Reporting – Cash (Not-for-profit) Standard.*

² The review identified problems with charities' financial statements, including concerns over inconsistent reporting formats, variety of accounting approaches, and the inadequate overall completeness and quality of information reported.

³ MED became part of the Ministry of Business, Innovation and Employment (MBIE) from 1 July 2012.

because they accept donations directly from the public and receive other types of preferential treatment, including income tax benefits (as noted on page 18 of the Discussion document). It was therefore considered important that all registered charities, regardless of size, have some form of statutory financial reporting requirements. We do not believe there have been any substantive changes in the charities sector that would require a reconsideration of this approach.

14. The Regulatory Impact Statement issued by MED in June 2011 looked at financial reporting requirements for a wide range of entities and detailed this for registered charities:

We considered the option of exempting micro-entities from reporting but were convinced by the Charities Commission⁴ and others that simple format cash reporting is a very important element of micro charity accountability and that having a single format would reduce compliance costs.

15. The feedback we have received from charities to date has highlighted general support for the Tier 4 Simple Format Reporting Requirements developed by the XRB. We have been told that compliance with these requirements has promoted consistent reporting across the sector, which has enabled these entities to “tell their story” and has made it easier for them to apply for funding and solicit donations.
16. We note that compliance reviews conducted by Charities Services from 2017-2018 have shown an increasing number of Tier 4 registered charities are complying with the new Simple Format Reporting Requirements. To continue this trend of increased adoption of XRB accounting standards by smaller charities, ongoing awareness and educational support may be required.
17. While we would be pleased to receive feedback on any improvements we can make to the Tier 4 Simple Format Reporting Requirements or the associated guidance material to assist in promoting greater compliance by smaller charities we would not extend this to a removal or reduction of the very basic information currently required to be reported.⁵
18. The XRB values its engagement with its constituency and is always open to discussion with small charities, or their representative umbrella groups, to improve the understandability of the Tier 4 accounting requirements.

Responses to specific questions in the Discussion document

19. We have provided response to specific questions related to financial reporting requirements under three sections of the Discussion document:
- (a) Obligations of Charities;
 - (b) Te Ao Māori; and
 - (c) Business.

⁴ Predecessor of Charities Services.

⁵ The XRB is conducting a Post-implementation Review of the Tier 3 and Tier 4 Simple Format Reporting Requirements over the 2019/2020 period.

Obligations of Charities – Reporting Requirements

Question: Is more support required for charities to meet their obligations? If so, what type of support is needed?

20. The requirements for Tier 3 and Tier 4 charities were developed with the non-accountant preparer in mind. To facilitate compliance, optional templates have been made available for Tier 3 and 4 charities on both XRB and Charities Services websites. The templates include detailed explanatory guidance written in non-technical language.
21. Despite extensive efforts by Charities Services and the XRB when the new requirements were introduced, we are aware that some registered charities are only now becoming aware of the new requirements.
22. We consider the 2018 Charities Services data that “only 58% of tier 4 charities successfully met the minimum reporting requirements”⁶ highlights that ongoing support is required from both the XRB and Charities Services, and other key stakeholders such as accounting professional bodies and philanthropic funders to assist in the continued improvement in smaller charities meeting their financial reporting obligations. This support could be in the form of education and awareness-raising activities in relation to Simple Format Reporting Requirements.
23. However, we are encouraged by the percentage increases in Table 1 which shows that Tier 4 had an increase from 37% compliance with these minimum financial reporting requirements in 2016 to 58% compliance in 2018.
24. We encourage the completion of further research and analysis by Charities Services to better understand the reasons for smaller charities not successfully meeting their minimum reporting requirements. Is non-compliance by certain smaller charities due to lack of awareness, simply avoidance, incomplete accounting records, or difficulties complying with specific reporting requirements? A better understanding of the reasons for non-compliance would assist in identifying appropriate courses of action.
25. The XRB is commencing a Post-implementation Review of the Accounting Standards framework in 2019–2020. This will be followed by a standards-level review of the Accounting Standards of the Simple Format Reporting Requirements. This review will provide an opportunity for the XRB to consider making refinements to the Tier 4 Simple Format Reporting Requirements and/or the associated guidance material to improve the understandability of the requirements.

⁶ Page 20 of the Discussion document.

Question: Should reporting requirements for small charities be reduced? If so, what would be the benefits? What would be the risks?

26. As noted earlier, the XRB is, in principle, opposed to the establishment of a new 'micro entity' tier for charities with less than \$10,000 operating expenditure and the suggestion that such entities should not be required to comply with current XRB reporting standards.
27. We consider that the current Tier 4 Simple Format Reporting Requirements continue to provide appropriate reporting requirements for the approximately 39% of registered charities with annual expenditure less than \$10,000. To maintain trust, confidence, accountability and transparency across the entire charities sector, we consider important that all charities, regardless of size, have some form of reporting requirements.
28. We support the promotion of financial literacy across all age groups as a complementary public policy objective to upskill all who may be required to comply with financial reporting requirements for their registered charity.
29. The XRB's view that reporting requirements for small charities should not be reduced, is supported by the reasons discussed below in paragraphs 30 to 32.
30. The new reporting requirements for registered charities require more time for full implementation by smaller charities.
 - (a) Given that the new reporting requirements have been in place for a relatively short time, we think it is important to consider the fact that the compliance statistics are still improving. Table 1 provides evidence of the improvement in financial reporting under the various tiers.⁷

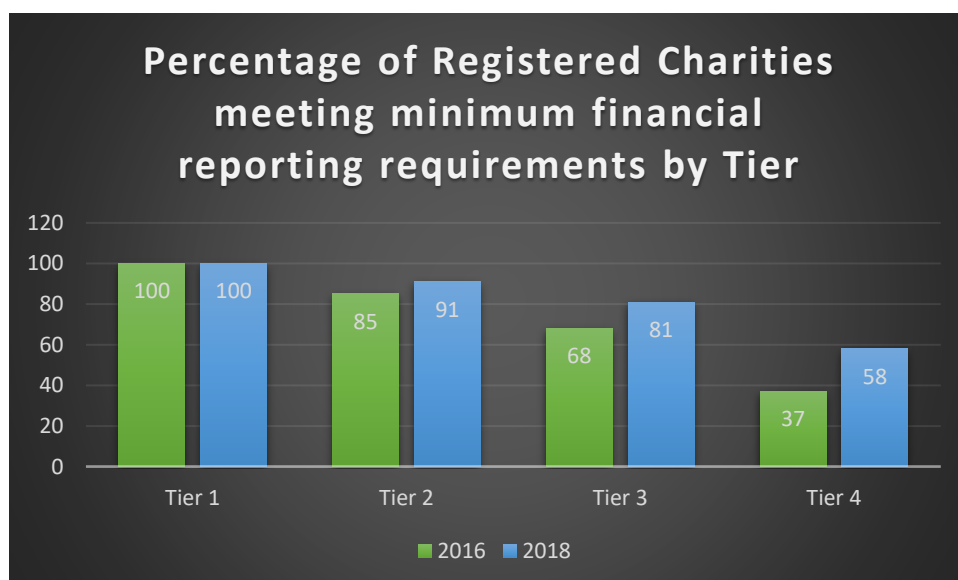


Table 1

⁷ Figures for the year ended 31 March 2016 were sourced from a presentation by Charities Services to the New Zealand Accounting Standards Board on 4 May 2017. The figures for the year ended 31 March 2018 are from the Discussion document on page 20.

- (b) As noted earlier, the Tier 4 level of satisfactory reporting has increased by 21%, from 37% for the year ended 31 March 2016 to 58% for the year ended 31 March 2018.
 - (c) We also note that the Tier 3 level of satisfactory reporting has increased by 13% from 68% for the year ended 31 March 2016 to 81% for the year ended 31 March 2018. We would expect to continue to see some improvement in these figures as all registered charities become aware of, and used to preparation under, the new reporting requirements. Despite extensive efforts by Charities Services and the XRB when the new requirements were introduced, we are aware that some registered charities are only now becoming aware of the new requirements.
 - (d) As well as showing that some entities are not meeting the current requirements, the statistics also show that many registered charities, including many small charities, are meeting the requirements. There is a need for a deeper understanding of the characteristics of those entities that are meeting requirements versus those entities not meeting requirements. **Non-compliance on its own should not drive changes to the statutory reporting requirements.**
31. Any change to the current statutory reporting requirements for smaller charities will cause confusion across the sector and potentially undo the positive results achieved to date.
- (a) XRB research shows that 14,557 charities reported under Tier 4 for the year ended 31 March 2018. Tier 4 comprises 71% of the total charities which have reported, or 14,557 charities. 58% of the preparers of Tier 4 Performance reports have successfully met the minimum reporting requirements. These preparers may well have availed themselves of the opportunities available, such as resources on the Charities Services and XRB websites, and attendance at roadshows and webinars. Now that these preparers have succeeded in reporting in compliance with XRB standards, they will not wish to be disrupted by a further change in their reporting requirements. Many of these small charities are doing a good job and their Performance Reports are clear and easily understood. The widespread use of the templates has led to much more consistent reporting in the sector and made it easier for users to compare the Performance Reports of different charities.
 - (b) Both the XRB and Charities Services from 2012 have been consistent in their messaging that all registered charities, regardless of size, have some minimum statutory financial reporting obligations. This messaging reflects the Government view that all registered charities are accountable to the donating public and must report in a transparent manner to engender public trust and confidence in the charitable sector. **Any change that provides an exemption from complying with XRB reporting standards for smaller entities will significantly weaken this message, leading to a likely decrease in the public's confidence across the entire charities sector.**
32. Many smaller charities currently eligible to report under Tier 4 Simple Format Reporting Requirements are opting-up to higher reporting requirements.

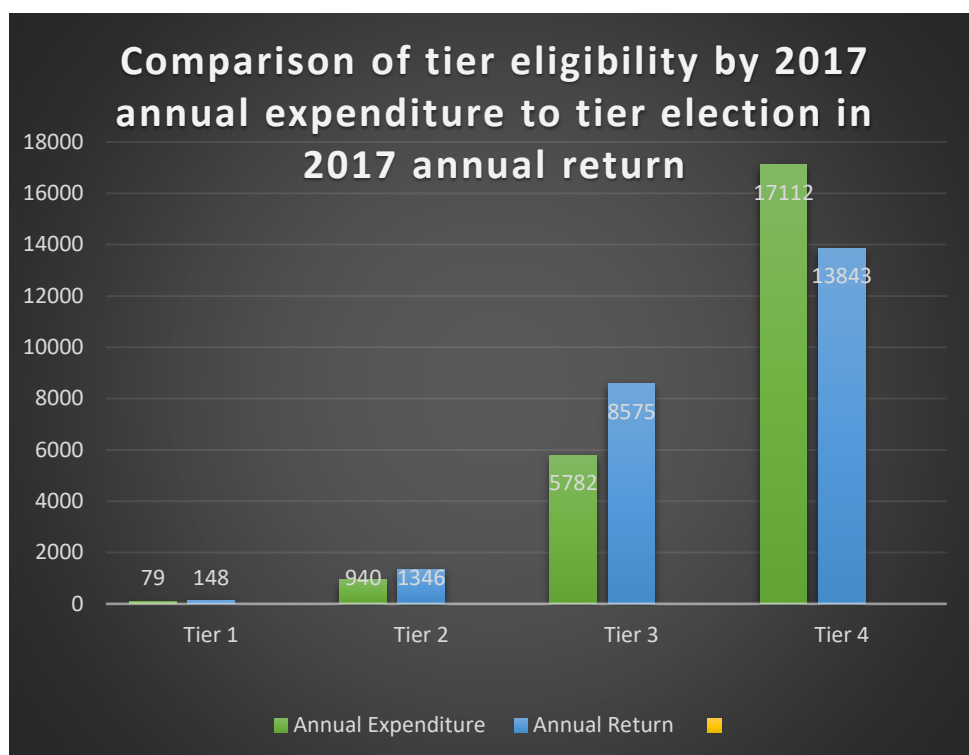


Table 2

- (a) Table 2 shows the absolute number of charities for 2017 across Tiers 2 to 4 were eligible to report in a Tier (green column), and the Tier which they elected to report under in their annual return (blue column). The difference between the two columns is the number which opted up to a higher reporting tier⁸.
- (b) For a percentage comparison, Table 3 shows the percentage of charities in each reporting tier based on annual expenditure in 2017.

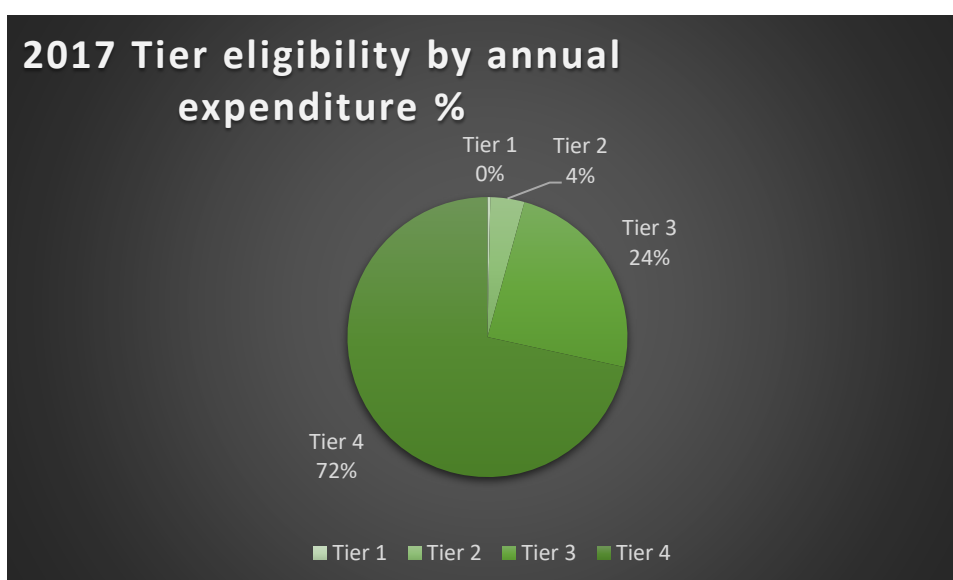


Table 3

⁸ No Tier 1 charities could opt up as they are already in the highest reporting tier.

- (c) Compare this to Table 4 which shows the percentage of charities in each reporting tier based on tier elected in their 2017 return.

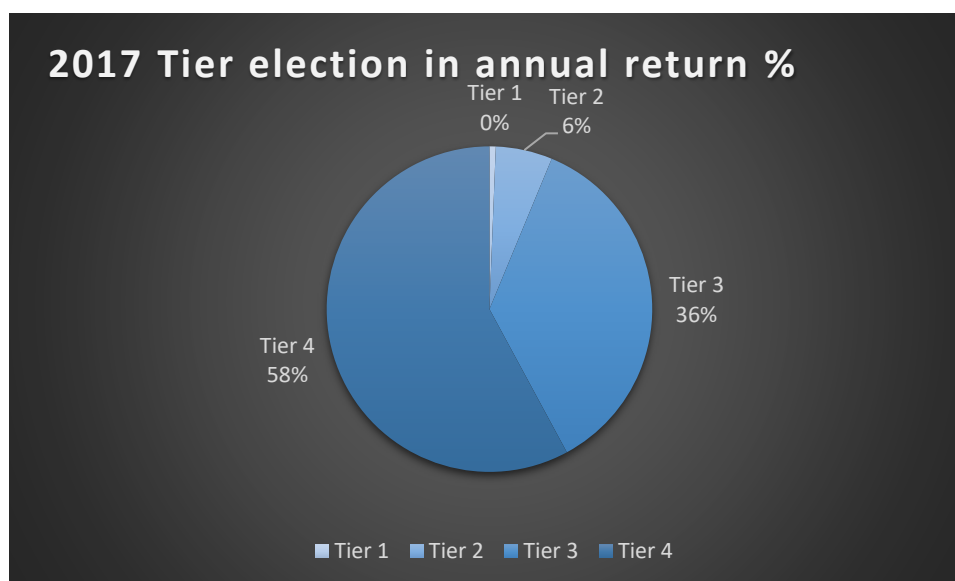


Table 4

- (d) The fact that 14% of, or 3,269, registered charities in the total annual returns submitted opted up from Tier 4 to a higher tier provides evidence that many small charities do not “struggle to meet reporting requirements”.⁹ Instead these charities in the sample have decided to use more complex reporting requirements by electing to report under a higher tier to better “tell the story” of their charity. Anecdotally, we understand from some auditors who act with many charities, that some small entities have opted up to Tier 3 accrual accounting have done so because they find the Tier 4 cash accounting too simplistic.
33. Rather than reducing reporting requirements, a more appropriate response to the concern noted in the Discussion document is to understand more about the reasons **why** some registered charities are not meeting their reporting requirements, as noted in paragraph 21 above.
34. We also note that Form 4 Annual return form for a Tier 4 Charitable entity contains 15 pages of mandatory information requirements of which only 3 pages relate to financial information.
35. Should the reporting requirements be removed for Tier 4 charities the XRB questions where the figures to complete the annual return will be obtained from? There would be no consistent basis for the provision of minimum financial information required in the annual return. The XRB consulted widely and put substantial effort into developing simple format reporting requirements for Tier 3 and Tier 4.
36. The Tier 4 requirements are on a cash basis and we particularly note the following:
- (a) The Statement of Service Performance for Tier 4 requires charities to only report on their outputs and not their outcomes. We envisage simple performance measures such

⁹ Heading on Page 20 of Discussion document.

as the number of newsletters produced, or a list of events organised such as the annual fair and a raffle. Providing these measures does not require any knowledge of accounting.

- (b) The Statement of Receipts and Payments is a cash account of what came into, and was paid out of, the charity's bank account.
- (c) The Statement of Resources and Commitments is a **list** of money owed to and by the entity at balance date. We also ask for a list of other resources such as a computer or a motor vehicle. This is not a "balance sheet" but was developed with a view to having some information readily available should the entity be required to report under Tier 3 where accrual accounting is required.
- (d) It is difficult to envisage how basic reporting could be made substantially simpler, albeit we would be very interested to learn of suggestions.

Te Ao Māori

Question: Are you aware of any particular problems with the reporting requirements for Māori charities?

- 37. No, the XRB are not aware of any particular problems with the reporting requirements for Māori charities.
- 38. However, the XRB sees this as a useful consultation question and will be interested in the feedback received. This feedback may assist in informing the XRB's Post-implementation Review of the Accounting Standards Framework currently timetabled for 2019/2020.

Business

Question: Should charities be required to report separately on business subsidiaries that they control that are not registered charities? If so, why?

- 39. The action following the responses to this question should be driven by the public demand for such information and the reasons given by respondents for wanting such information. For example, do users consider that such information would be useful to them in making decisions about donating to a charity?
- 40. We note that section 50 of the Charities Act 2005 gives Charities Services fairly broad powers to investigate a charitable entity. Before establishing new reporting requirements it would be helpful to confirm the extent to which section 50 of the Act would permit Charities Services to inquire into a business subsidiary of a registered charity which is not itself a registered charity. In particular, subsections 50(2)(a), (c) and (e) appear to be worded broadly enough to enable Charities Services to inquire into activities that generate inflows to, or outflows from, a registered charity or that expose the charity to business risks.
- 41. It would be useful to understand who is requesting further financial information on the activities of significant business subsidiaries that are controlled by registered charities. Is it the users of performance reports filed with Charities Services (e.g. donors, grantors and the

broader public) or the sector regulator? This feedback will assist in determining whether any changes are needed to the statutory reporting obligations of registered charities and/or their subsidiaries, or to the requirements of particular accounting standards.

Closing comments

42. For the reasons explained earlier in our introductory comments, we have not commented on other questions in the Discussion document.
43. We would welcome the opportunity to meet with the Charities Act Policy Team to discuss these matters further. If you have any queries or require clarification of any matters in this submission, please contact Judith Pinny (Judith.pinny@xrb.govt.nz) or me.

Yours sincerely

Michele Embling
Chair
External Reporting Board

Appendix 1

Background information on the development of XRB Simple Format Reporting Requirements

1. The new reporting standards for registered charities came into effect on 1 April 2015 following a review of the quality of annual reporting by registered charities in 2009 by the MED. This review identified problems with the financial statements of registered charities, including concerns over inconsistent reporting formats, use of a variety of accounting approaches, and problems with the overall completeness and quality of information reported.
2. The Regulatory Impact Statement issued by MED in June 2011 looked at financial reporting requirements for a wide range of entities and detailed this for registered charities:

We considered the option of exempting micro-entities from reporting but were convinced by the Charities Commission and others that simple format cash reporting is a very important element of micro charity accountability and that having a single format would reduce compliance costs.

3. To address these issues, legislation was enacted requiring all registered charities to prepare annual financial statements in accordance with accounting standards issued by the XRB. The primary basis for introducing new statutory reporting requirements under amendments to the Charities Act 2005 in 2013 was the view that all registered charities are accountable to the public and must report in a transparent manner to engender public trust and confidence in the charitable sector. It was therefore considered important that all registered charities, regardless of size, have some form of standardised financial reporting requirements.
4. In response to these legislative changes, the XRB developed accounting standards for those not-for-profit PBEs who have a statutory requirement to prepare financial statements in accordance with accounting standards issued by the XRB, including registered charities. The tiers are generally based on the charity's annual expenditure over the previous two financial years. Larger charities in Tier 1 and Tier 2 are subject to more rigorous reporting requirements, consistent with international standards. If a charity has "public accountability" as defined in XRB A1¹⁰ then it is automatically required to report under Tier 1.
5. The XRB developed the reporting framework for PBEs after extensive consultation with the not-for-profit sector and, in particular, with registered charities. A not-for-profit working group was formed and provided a report to the XRB in November 2011 entitled *Simple Format Reporting for NFP Entities*.¹¹ The working group focused on two main issues: what statements should be included in the simple format financial reports of NFP entities; and what specific items should be disclosed in those statements. Experienced preparers and users of financial reports from across the not-for-profit sector were members of this group. This report formed the basis for developing the Tier 3 and Tier 4 Simple Format Reporting Standards for Registered Charities.

¹⁰ <https://www.xrb.govt.nz/accounting-standards/not-for-profit/xrb-a1/>, paragraphs 7-13.

¹¹ <https://www.xrb.govt.nz/dmsdocument/1822>

6. The XRB also commissioned research to identify the typical transactions in charities. This research assisted the XRB in developing standards for Tier 3 and Tier 4 registered charities that were fit for purpose. It was also used in considering whether any NFP modifications were needed to the standards that had been developed for Tier 1 and 2 public sector PBEs.¹²
7. A further report was commissioned by the XRB in 2012, this time focusing on *Reporting Entity Concepts for Tier 1 and Tier 2 NFP Entities*.¹³ Experienced leaders in charity reporting from across the not-for-profit sector were members of this group.
8. We have outlined the research that informed the development of standards for registered charities to show that the current standards were written from an evidence basis.
9. Once the standards had been developed, the XRB, together with Charities Services and other agencies completed four rounds of nationwide road shows to bring awareness of the new reporting standards to the registered charities and give attendees a chance to ask questions about the new standards. Response to the new standards was very positive. Attendees understood that transparency of their charity was necessary to engender confidence and trust in the charitable sector and to qualify for the tax exemption. The XRB and Charities Services also held webinars which were well attended.

¹² <https://www.xrb.govt.nz/dmsdocument/1823>

¹³ <https://www.xrb.govt.nz/dmsdocument/1824>