Te Tari Taiwhenua
Internal Affairs

19 November 2019

External Reporting Board

Targeted review of the accounting standards framework

I am pleased to provide a submission to the External Reporting Board ("the XRB") on the Targeted Review of the New Zealand Accounting Standards. Charities Services' functions under the Charities Act 2005 include supporting registered charities in meeting their obligations to prepare financial statements that comply with generally accepted accounting practice.

Our vision is that our work contributes to a well-governed, transparent, and thriving charitable sector with strong public support. We strongly support any changes to the Framework that make it easier for charities to comply, and that promote public trust and confidence in the charities sector. Now that the not-for-profit financial reporting standards have been in place for four years, we support this review as an opportunity to assess whether the Framework is functioning well for charities and the public. It also represents timely consideration of the process by which the financial reporting standards are set to ensure they remain relevant and appropriate for registered charities.

Summary of key points of our submission (more detail is in the appendix)

- We are not aware of any developments in financial reporting by registered charities that would suggest the fundamental features of the Framework are inappropriate.
- In our experience it is more important to registered charities that the financial reporting standards appropriately reflect the environment in which they operate, rather than that they closely align to international standards. We support formalisation of a more flexible approach to setting not-for-profit financial reporting standards to allow for this.
- We do not consider that the benefits of introducing an asset-based threshold to the reporting tier criteria would outweigh the costs to the charitable sector. Given the increase over time in the number of entities that are required to move from Tier 3 to Tier 2 reporting we recommend considering adjustments to the thresholds on a regular basis to reflect the growth of the sector.

While I am aware that this consultation is not considering the specific reporting requirements that apply to small charities, we are keen to engage with you about this. From our experience these charities struggle to meet current reporting requirements. We look forward to discussing how to make it easier for these charities when you start the next phase of the review.

If you have any questions about the matters discussed in this submission or would like to discuss further, please contact Jamie Cattell via email at Jamie.Cattell@dia.govt.nz or via phone at 04 382 3503.

Yours sincerely

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Appendix A

General Comments: Accounting standards framework

1. As the New Zealand Accounting Standards Framework ("the Framework") currently stands, Charities Services is not aware of any specific developments in financial reporting by registered charities that would require any changes to its fundamental features.
2. We consider that the split of the Framework into for-profit and Public Benefit Entity ("PBE") standards is appropriate and allows for it to adequately address the unique circumstances that apply to PBEs, including registered charities. While an argument could be made that not-for-profits represent a third sector requiring an individual set of standards different than that which applies to public sector entities, we do not believe the costs of such an approach would outweigh the benefits. This is particularly true considering the flexibility the XRB has already demonstrated by allowing for differences between the way not-for-profit and public sector entities apply the PBE standards.
3. We also consider that the multi-tier approach is generally appropriate in ensuring the reporting requirements for PBEs reflect their size and nature. While several issues have been raised with us about the specific content of the Tier 3 and Tier 4 standards, none of them have been about use of the multi-tier approach in general. Further, we understand that the content of the Tier 3 and Tier 4 standards will be addressed in a separate review following this targeted review of the framework.

SMC 1: Importance of maintaining close alignment between PBE Standards and IPSAS

4. Most of the comments we receive on the standards relate to disagreement with specific elements of the PBE standards which is true across all reporting tiers. It has not been raised with us that registered charities or their advisors consider it important that PBE standards are closely aligned with IPSAS.
5. However, the feedback we have received on the elements of the standards has indicated that some are concerned they may not have been sufficiently tailored for New Zealand charities. We acknowledge that the XRB has already demonstrated flexibility in its approach to adopting IPSAS and we suggest that formalising this more flexible approach and lowering the threshold at which modifications may be made could help address some of these concerns in the future.
6. In cases where comments have been made which could apply to the Framework directly, they often reflect either:
    a. Dissatisfaction with the length of time it may take to address any concerns raised. For example, difficulties in applying PBE IPSAS 23; or
    b. The basis on which standards were adopted. In particular, why IPSAS was used.
7. We also consider that adopting a more flexible approach, which allows for early development of new PBE standards ahead of a related IPSAS, will make it easier to address any concerns in a timely manner.

SMC 2: Importance of retaining harmonisation with Australia for Tier 2 for-profit disclosures

8. We have no comments on this SMC. As it relates to the for-profit standards, the relevance to registered charities in NZ is limited. While some registered charities control for-profit entities, these are often based and operate entirely in NZ.

SMC 3: Do the PBE tier size criteria need to be revisited?

9. We consider there are two key issues to discuss under this matter. First whether the operating expenditure thresholds need to be altered, and second, whether introduction of an asset-based threshold would be appropriate.
10. Given that the Tier 4 threshold cannot be altered by the XRB, the threshold with the largest potential impact being considered is the Tier 3 threshold of $2m operating expenditure. Based on our data, moving the threshold would not have a significant impact on the number of entities which are eligible for Tier 3. For example, based on 2018 annual returns, moving the expenditure threshold from $2m to $10m would increase the percentage of entities which qualify for Tier 3 by approximately 3%.
11. Despite this, we also note that between 2013 and 2018 there has been a slight upward drift in terms of the number of entities reporting at Tier 3 and Tier 2 from 3% to 4%. This is to be expected while static thresholds are in place. If it is assumed that the Tier distribution as it stands is appropriate, then it would be reasonable to introduce adjustments considered on a regular basis to reflect the growth of the sector over time.
12. While some concerns have been raised with us about entities with large assets being eligible to report under Tier 4 due to its focus solely on operating expenditure, we agree with the preliminary view that introducing an asset-based threshold is not appropriate.
13. The rationale presented in the discussion paper that supports this view is persuasive. In particular, we agree that due to the nature of the assets held by these entities (generally endowment funds and heritage assets), introduction of an asset-based threshold would not present a useful benchmark for the size of an entity’s operations. We also do not consider that the benefits of additional transparency by these entities reporting under a higher Tier outweighs the costs to the charitable sector of the additional complexity and compliance burden it would introduce. An asset-based threshold could force small entities with significant but passive assets into preparing Tier 2 financial statements in situations that would be overly burdensome.
14. Beyond the complexity of measuring against two thresholds, one of the most common challenges faced by registered charities is determining the value of heritage assets or specialised assets such as church buildings. Having an asset threshold would either require them to estimate the value, use rateable value which may not be appropriate, or obtain an independent valuation which is often costly.