

# Public Benefit Entity Tier Sizes

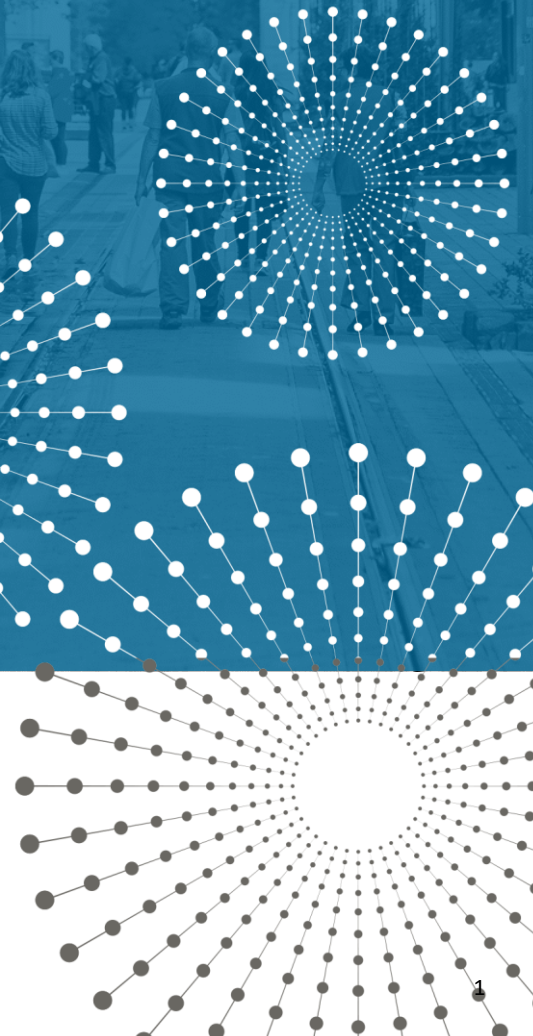
## Proposed Increases in the Thresholds

Consultation document



October 2023

Consultation closes 26 January 2024





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# PART ONE: Introduction

## 1.



## What is this consultation document about?

The External Reporting Board (XRB) has issued this consultation document to seek feedback on its proposals to amend the PBE tier sizes in its Accounting Standards Framework to increase the tier 2 and tier 3 thresholds as follows:

Tier	Current Criteria	Proposed Criteria
<b>Tier 2</b>	No public accountability and Not large (total expenses ≤ <b>\$30 million</b> )	No public accountability and Not large (total expenses ≤ <b>\$33 million</b> )
<b>Tier 3</b>	No public accountability Total expenses ≤ <b>\$2 million</b>	No public accountability Total expenses ≤ <b>\$5 million</b>

Since 2012, New Zealand's financial reporting requirements have been governed by two interacting frameworks.

- **The Statutory Reporting Framework** – which is set in legislation and establishes **who** has to report in accordance with accounting standards issued by the XRB.
- **The Accounting Standards Framework (ASF)** – which is developed and issued by the XRB and establishes the strategy for determining **what** accounting standards an entity must follow when they are required to prepare General Purpose Financial Reports (GPFs) by the statutory reporting framework.

When the ASF was established, it included an initial set of size thresholds dividing Public Benefit Entities (PBEs) into four reporting tiers. The tiered structure in the ASF ensures that PBE GPFs meet the information needs of users and that the cost of preparing that information does not outweigh its benefits to users.

While the XRB recently considered the size thresholds as part of the 2019 targeted review of the ASF, no changes were made at that time. Therefore, most of the size thresholds have not been adjusted from their original levels set in 2012.

However, the following recent factors indicate that it is timely to reassess and adjust the size thresholds.

- **Legislative changes related to financial reporting** – Specifically, the Financial Reporting (Inflation Adjustments) Regulations 2021 and the Incorporated Societies Act 2022.
- **Balance of costs and benefits** – While the XRB considers the costs and benefits before issuing each new standard, the entire suite also needs to be considered holistically. The issuance of several new substantive PBE standards without reconsidering the size thresholds presents the risk that the benefits of reporting do not exceed the costs for smaller tier 2 PBEs.
- **Inflationary pressure** – Over time, the effects of inflation have shifted entities from tier 3 to tier 2, without those entities in real terms becoming larger or more complex.



The XRB is proposing to amend the size thresholds follows.

### The tier 2 threshold

The XRB is proposing to increase this threshold from \$30 million to \$33 million to align with the definition of “large” in the Financial Reporting Act 2013 which has recently been amended from \$30 million to \$33 million.

### The tier 3 threshold

The XRB is proposing to increase this threshold from \$2 million to \$5 million. The definition in legislation that this threshold was originally based on is no longer in effect due to the repeal of the Financial Reporting Act 1993. Therefore, the XRB has applied judgement to identify a threshold which would:

- Take account of the effects of inflation since 2012
- Future proof the ASF until the XRB carries out a first principles review
- Reflect the ASF’s objective for the benefits to exceed the costs of reporting for smaller tier 2 PBEs.

Your feedback will help us assess whether the proposed expenditure thresholds are appropriate.

### What is not in scope?

The following matters are **not within the scope** of this consultation.

- The **accounting requirements** in specific standards issued by the XRB.
- The **auditing and assurance requirements** that apply to financial statements.
- The **requirements in legislation** that specify which entities must prepare financial statements in accordance with accounting standards issued by the XRB.
- The **tier 4 threshold** which is set directly within the Financial Reporting Act 2013.



## 2.

### How to provide feedback?

#### Responding to consultation questions

We are seeking comments on the questions below. We will consider all comments received before finalising the proposed tier size thresholds.

- Q1.** Do you agree with the proposal to increase the tier 2 PBE size threshold from \$30 million to \$33 million? Why or why not?
- Q2.** Do you agree with the proposals to increase the tier 3 PBE size threshold from \$2 million to \$5 million? Why or why not?
- Q3.** Do you have any other comments you would like to make on the PBE tier size thresholds?

#### Making a submission

You can provide feedback to us via:

- the consultation page on our website (where you can upload a PDF or complete an online form); or
- emailing your formal or informal comments to [accounting@xrb.govt.nz](mailto:accounting@xrb.govt.nz)

The consultation closes on **26 January 2024**

Figure 1: Timeline



#### Publication of submissions, the Official Information Act and the Privacy Act

We intend on publishing all submissions on the XRB website ([xrb.govt.nz](http://xrb.govt.nz)), unless the submission may be defamatory. If you have any objection to publication of your submission, we will not publish it on the XRB website. However, it will remain subject to the Official Information Act 1982 and, therefore, it may be released in part or in full. The Privacy Act 2020 also applies.

If you have an objection to the release of any information contained in your submission, we would appreciate you identifying the parts of your submission to be withheld, and the grounds under the Official Information Act 1982 for doing so.



# **PART TWO:**

## **Supporting Information**

# 3.



## About the Accounting Standards Framework

### 3.1 Objectives of the ASF

#### ***Meeting user needs***

This is achieved by developing accounting standards that provide the information users need to make informed decisions. This is reflected by the ASF's multi-standards approach which provides accounting standards tailored to the PBE sector.

#### ***Balancing the costs and benefits of reporting***

This is achieved by the ASF's tiered structure which provides reduced reporting requirements for smaller, less complex entities such that the benefits of reporting exceed the costs for those entities.

### 3.2 Current PBE Tier Structure

Under the multi-tier approach the current ASF divides PBEs into four tiers based on their total expenses. The XRB concluded that total expenses is the most appropriate benchmark for a PBE's size because it:

- generally reflects a PBE's activity level; and
- is less subject to isolated events than revenue which is often variable for PBEs (for example due to multi-year funding arrangements or unexpected donations).

The current tier structure as it applies to PBEs in the ASF is provided in the table below. Except for tier 4, the XRB have not adjusted these thresholds since they were first established in 2012.

Tier	Criteria	Standards	Legislative base
Tier 1	Has <a href="#">public accountability</a> , or is large (total expenses > \$30 million)	PBE Standards	Definition of "large" in the <a href="#">Financial Reporting Act 2013</a> . <i>Note – the definition of "large" was updated by the <a href="#">Financial Reporting (Inflation Adjustments) Regulations 2021</a></i>
Tier 2	No public accountability and Not large (total expenses ≤ \$30 million)	PBE Standards Reduced Disclosure Regime (PBE Standards RDR)	<a href="#">Financial Reporting (Inflation Adjustments) Regulations 2021</a>
Tier 3	No public accountability Total expenses ≤ \$2million	Reporting requirements for Tier 3 Entities (The Tier 3 Standard)	Currently no basis in legislation. Formerly based on "exempt company" threshold in the Financial Reporting Act 1993.
Tier 4	No public accountability and Allowed by law to use cash accounting (operating payments < \$140,000)	Reporting Requirements for Tier 4 Entities (The Tier 4 Standard)	Definition of "specified not-for-profit entity" in the <a href="#">Financial Reporting Act 2013</a> .





### 3.3 Targeted review of the ASF

In 2019 the XRB carried out a targeted review of the ASF. The primary objective of the targeted review was to assess whether the accounting standards framework (ASF) was operating as intended and if it was fulfilling its original objectives. The consultation included whether the PBE tier size criteria need to be revisited. For more information on the targeted review refer to the [XRB website](#).

#### Primary factors for reconsidering the size criteria

While the XRB did not amend the size criteria at that time, they set out the following primary factors which it considered as indicators that the size criteria need to be amended.

**1**

##### Establishment of new statutory reporting requirements

In particular, the introduction of new statutory reporting requirements for incorporated societies.

**2**

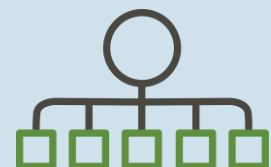
##### Observations on the application of the accounting requirements of each tier

Whether any significant challenges arise for PBEs applying the accounting requirements of each tier.

**3**

##### The spread of PBEs across the four tiers

If the spread of PBEs across the tiers changes significantly or otherwise appears inappropriate, including changes due to inflation or other economic factors.





# 4.

## The case for reassessment

### 4.1 Legislative developments

Since the targeted review of the ASF was completed, two pieces of legislation have been passed that relate to financial reporting requirements. Both of which support commencing a review of the PBE tier size thresholds.

- [Financial Reporting \(Inflation Adjustments\) Regulations 2021](#)
- [Incorporated Societies Act 2022](#)

#### Financial Reporting (Inflation Adjustments) Regulations 2021

These regulations adjusted various financial reporting thresholds set in legislation. Two of those thresholds currently have a direct relationship with the PBE tier size thresholds.

Threshold	Original level	New level
<b>Meaning of large Section 45 (1) of the Financial Reporting Act 2013</b>	Assets > \$60 million Revenue > \$30 million	Assets > \$66 million Revenue > \$33 million
<b>Meaning of “specified not-for-profit entity” Section 46 of the Financial Reporting Act 2013</b>	Operating Payments > \$125,000	Operating Payments > \$140,000

The first specifies whether an entity is ‘large’ under the Financial Reporting Act 2013. This definition was used as the basis for the initial tier 2 threshold. Given that this threshold is still in effect, the XRB consider the threshold in XRB A1 should be amended to reflect the increase.

The second defines which entities are “specified not-for-profit entities”. As this threshold also directly functions as the tier 4 threshold, the XRB have already adjusted this threshold via an amendment to XRB A1 issued in December 2021.

#### The Incorporated Societies Act 2022

In April 2022 the Incorporated Societies Act 2022 was passed into law. The effect of this Act is to require all incorporated societies, except for those that meet the definition of a “small society”, to apply XRB accounting standards.

The introduction of the Incorporated Societies Act 2022 was specifically identified as a trigger condition for review of the size criteria. The XRB made this legislation a trigger condition because they want to consider whether the ASF, PBE tier size criteria, and associated accounting standards are appropriate for incorporated societies generally prior to them becoming mandatory.



## 4.2 Observations on the application of accounting standards

### Effects of new standards

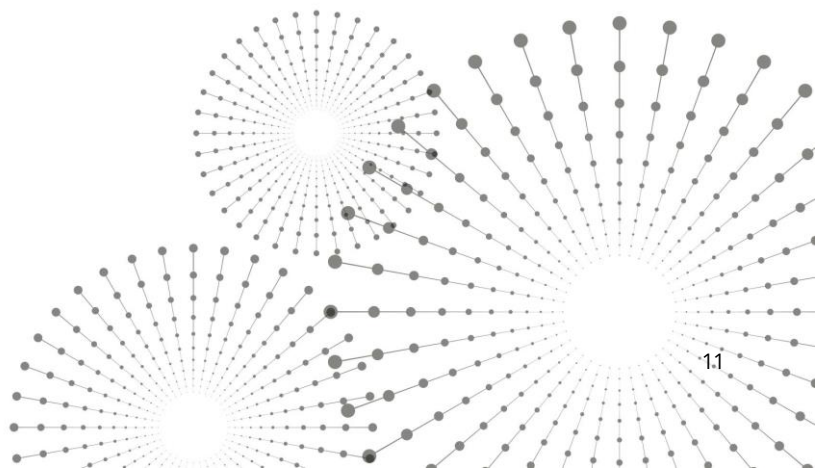
Accounting standards are updated over time to improve the quality, reliability, and transparency of financial reporting. Usually, they are updated to add new requirements or amend existing ones to respond to changes in the way entities operate, or changes in the information that users need.

When responding to these changes, the XRB must always bear in mind the need for the benefits of reporting to exceed the costs. While the XRB considers the costs and benefits before issuing or amending a standard, the entire suite also needs to be considered holistically.

Since the ASF and the tier size thresholds were first set, there have been several substantive new accounting standards issued and incorporated into the PBE suite of accounting standards. There are also several other substantive accounting standards on the XRB work programme. It is therefore important to consider whether the tier size thresholds result in the benefits of reporting exceeding the costs now and into the future.

Recent feedback we have received from public consultations indicates that constituents are concerned that the costs of reporting exceed the benefits to users under the current size thresholds. For example, in a recent ED consultation we received comments that the tier 3 threshold should be increased.

While these comments are not application issues related to specific PBE standards, the XRB consider that they indicate application challenges across the suite of PBE standards which support reassessing the size thresholds with a particular focus on the tier 3 threshold.



### 4.3 The spread of PBEs across the tiers – Number of tier 2 Entities



To assess the current spread of the PBE population, the analysis below focuses on registered charities for the following reasons.

- As not all NFP PBEs are required to apply XRB standards or file publicly, the annual return data of registered charities was used to understand the current spread of NFP PBEs by size and the impact of any changes to the current size thresholds. Registered charities make up approximately 95% of the population of NFP PBEs currently required to apply XRB standards.
- A significant number of incorporated societies (approximately 6,000) are registered charities. Therefore, we expect the traits of this population are reflected in the registered charity dataset.
- Most public sector PBEs are schools, and all schools are required by the Ministry of Education to report in accordance with tier 2. Therefore, changes to the tier sizes within the XRB's mandate are unlikely to significantly affect the proportion of public sector PBEs reporting under each tier.

Over time the number of NFP PBEs which fall into tier 2 has increased. The table below compares the total number of registered charities which meet the tier 2 size criteria based on the annual returns filed for balance dates on or between 31 March 2016 and 30 March 2017 with the most recent annual returns filed as at 30 June 2023.

	2016 - 2017		30 June 2023		Change	
	Number	%	Number	%	Number	%
<b>Tier 1</b>	69	<1%	126	<1%	57	<1%
<b>Tier 2</b>	859	4%	1,185	5%	326	1%
<b>Tier 3</b>	5,175	22%	6,169	24%	994	2%
<b>Tier 4</b>	17,666	74%	18,600	71%	934	- 3%
<b>Total</b>	<b>23,769</b>		<b>26,080</b>		<b>2,311</b>	

Tier 2 entities represent a small portion of the total registered charity population. Therefore, any increase in their number will appear to be a small change when considered as a percentage of the total NFP population. However, when considered against the population of tier 2 entities in 2016 – 2017 an increase of 326 entities represents a 38% increase in the total population of tier 2 entities. The XRB considers this increase to be substantial.

The XRB expects that the increase can be attributed to the following three factors.

- New entity registrations between the two periods.
- Increases in scale of existing entities.
- Inflation, which results in increased total expenditure without an increase in scale.

We do not consider that the first two reasons above would support reassessing the tier size thresholds. However, changes due to inflation would support reviewing them as an increase in expenses would not reflect a change in the entity that warrants increased reporting requirements.



To determine the change in the population which may be attributable wholly or partially due to inflation the XRB have identified entities:

- Which remained registered between 2016 – 2017 and 30 June 2023.
- Whose total expenditure in 2016 – 2017 was less than \$2 million;
- Whose total expenditure was greater than \$2 million in their most recent return at 30 June 2023.
- Whose total expenditure in 2016 – 2017 is greater than the discounted tier 3 threshold of \$1.6 million.

*The threshold was discounted based on the inflation rate published on the [Reserve Bank website](#) of approximately 23% between 2016 - 2017 and 2023.*

This data is summarised in the table below.

Expenditure in 2016 - 2017	Number of entities	% of tier 2 population at 30 June 2023	% of increase in tier 2 population
< \$140,000	31	3%	10%
\$140,000 - \$1 million	91	8%	28%
\$1 million - \$1.6 million	104	9%	32%
> \$1.6m	74	6%	23%
<b>Total</b>	<b>300</b>	<b>25%</b>	<b>92%</b>

Of the increase in the number of tier 2 entities of 326 discussed on the previous page, 300 of those entities were continuing entities.

Among the 300 continuing entities:

- 74 had total expenditure of \$1.6 million or more in 2016 – 2017 and would have exceeded the threshold solely due to inflation. These entities account for 23% of the change in the total number of tier 2 entities.
- 104 had total expenditure between \$1 million and \$1.6 million in 2016 – 2017. An increase in scale of these entities' activities may account for them exceeding the threshold, but inflation could still be a contributing factor. These entities account for 32% of the change in the number of tier 2 entities.

Taken together, these points imply that 55% of the increase in the number of tier 2 entities could be solely or partially due to inflation between 2016 - 2017 and 30 June 2023.

The XRB considers that the above provides sufficient evidence that the PBE tier size thresholds need to be revisited to correct for the shift.



# 5.

## Determining a new tier 3 threshold

As the tier 3 threshold was derived from the Financial Reporting Act 1993 which has since been repealed, determining the appropriate level requires judgement. Based on the analysis outlined earlier, the XRB considered various options to identify a threshold which would:

- Take account of the effects of inflation on the number of tier 2 entities.
- Future proof the ASF until the XRB carries out a first principles review.
- Reflect the ASF's objective for the benefits to exceed the costs of reporting.

The XRB ultimately settled on a threshold of \$5 million as the most effective.

The effect of setting the tier 3 threshold at \$5 million on the population of registered charities that would fall into tier 2 based on the 30 June 2023 annual return data has been summarised in the table below.

Threshold	Tier 2 population	Tier 2 population as a % of total	Change from current	Change from FY 2016 - 2017
Current (\$2,000,000)	1,185	5%	- 0	326
\$5,000,000	530	2%	- 655	- 329

To sense check the \$5 million threshold, the XRB applied the same approach as it used during the targeted review. This is described in the quote on the right.

In following that approach, the XRB have considered the spread of registered charities by total expenses to identify the expenditure levels around which there is significant clustering.

*Given that the accounting requirements in the tier 3 standard are significantly simplified as compared to the requirements of tier 2, the XRB would be concerned if there were a substantial percentage of entities within tier 2 with annual expenditure just over the new tier 3 size threshold.*

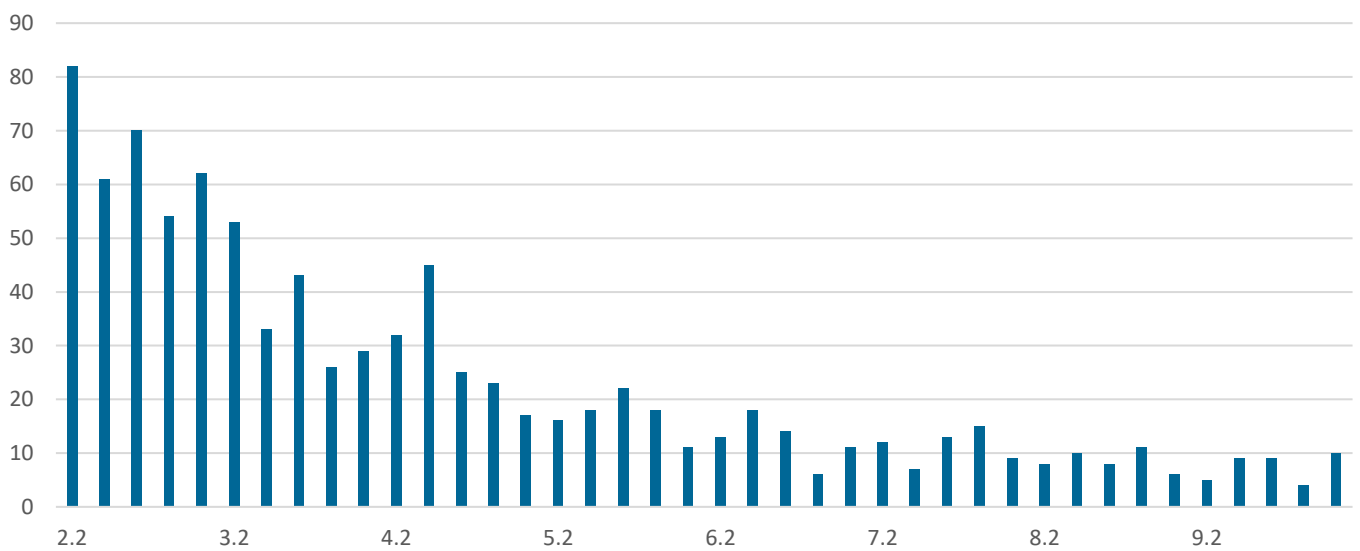
*In this scenario, there would be a need to question whether it was reasonable that a small excess in size requires such a significant increase in reporting requirements, based on cost-benefit considerations.*



The graph below shows the number of entities with total expenditure between \$2 million and \$10 million grouped into buckets of \$200,000. The x-axis shows the upper limit of that bucket. For example, a label of 2.2 represents the number of entities with total expenditure between \$2 million and \$2.2 million.

The data shows that there is substantially less clustering around the \$5 million threshold. In total there are 33 entities with total expenditure between \$4.8 million and \$5.2 million while there are 115 entities with total expenditure between \$2.8 million and \$3.2 million.

### Number of entities by total expenditure



The XRB therefore propose increasing the tier 3 threshold to \$5 million which accounts for both the effects of inflation, and supports the ASF’s objectives.

It is also important to highlight that any change in the mandatory thresholds for reporting in a higher tier would not preclude entities voluntarily opting up to a higher tier. That is the ASF will continue to allow PBEs to apply the requirements of higher tiers where they consider the benefits of doing so outweigh the costs in their specific circumstances.



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