Perspective

This is one of a series of articles where experts in assurance, reporting and regulatory matters discuss recent technical and policy developments in these areas

Change is on its way for Incorporated Societies in New Zealand

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1908 was a great year for New Zealand. The first passengers travelled by train on the North Island main trunk line, the legendary Edmonds Cookery Book was published and New Zealanders competed in the Olympic Games for the first time. 1908 was also the year our Incorporated Societies Act was introduced. This Act has governed the operation of incorporated societies for 111 years now!

As I'm sure you'll agree, much has changed in the world since 1908, and the Government has decided that the 1908 Act needs modernising to ensure it keeps up to speed with these changes.

What are incorporated societies and what does the 1908 Act require?

According to the Act, incorporated societies are groups or organisations registered under the Incorporated Societies Act 1908 which, when incorporated, are authorised by law to run their affairs as though they were an individual person. This means that:

- members are not personally liable for the society's debts, contracts or other obligations
- members do not have any personal interest in any property or assets owned by the society.

Once incorporated, incorporated societies continue to exist as long as they file certain documents with the Registrar of Incorporated Societies or until their members, or a creditor, decide to bring the society to an end. From perusal of the Register it appears that action does not seem to have been taken to remove incorporated societies which have not filed the required information in a number of years (in some cases more than 10).

A wide range of groups and organisations operate as incorporated societies, including sports clubs, social clubs, music and cultural groups, special interest and activist organisations. There are more than 23,000 incorporated societies currently on the register.

What's changing?

A draft Incorporated Societies Bill, which proposed a broad range of changes to the way incorporated societies operate, was open for public consultation from October 2015 to June 2016. An overwhelming 116 submissions were received from organisations as diverse as Master Plumbers, NZ Winegrowers, Federated Farmers, Acupuncture New Zealand and the Cycling Action Network. The Ministry of Business Innovation and Employment (MBIE) considered these submissions and, in May 2019, the Government's Cabinet Economic Development Committee reviewed the proposals and announced its intended amendments to the draft Bill[1]. The Bill is expected to be introduced into Parliament later this year. In this article, we consider the key proposed amendments in relation to reporting and assurance requirements, as well as the transition process.

Reporting requirements

Under the 1908 Act, incorporated societies have reporting requirements but are not required to prepare financial reports in accordance with any prescribed standards or format, which results in a wide variety of reporting. Consequently, there is a lack of transparency over the financial affairs of incorporated societies and financial information is often difficult to compare and understand. The draft Bill originally required all incorporated societies to prepare their financial statements in accordance with the accounting standards set by the External Reporting Board (XRB) – general purpose financial reports (GPFR). Following the recent Cabinet decision, incorporated societies which are not registered charities will only be required to report using standards issued by the XRB when they satisfy one or more of the following criteria:

- Annual payments of $10,000 or more
- Assets of $30,000 of more
- "Donee status" under the Income Tax Act 2007.

Presumably, those that do not meet the criteria will be able to continue preparing special purpose financial reports (SPFR).

About one third of all incorporated societies are also registered charities, and all registered charities have been required to report under the XRB standards since 2016. The Accounting Standards Framework involves multiple standards across different entity types and four reporting tiers. This reflects the different needs of the for-profit, public and not-for-profit sectors. The reporting tiers ensure the standards are appropriate for the size of the organisation. Entities applying the not-for-profit standards are also required to prepare non-financial information, to help readers understand what the entity has achieved, as well as financial information. Broader reporting, and the information value this provides, has been heralded as one of the key successes arising from the introduction of XRB standards to registered charities in New Zealand.

Research[2] on incorporated societies undertaken in March 2016 found that 42% of entities had expenditure of less than $10,000. As such, setting the threshold at $10,000 payments is likely to remove the requirement to prepare financial statements in accordance with XRB standards for almost half of New Zealand's incorporated societies.

Assurance requirements

Under the 1908 Act, there is no requirement for incorporated societies to obtain an audit or review of their financial reports. The draft Incorporated Societies Bill was also silent on assurance requirements.

The proposed new legislation proposes a mandatory audit requirement where incorporated societies, which are not registered charities, satisfy one of the following criteria:

- Annual expenditure over $2 million
- Assets over $4 million.

The $2 million expenditure threshold would correspond to the reporting threshold for 'Tier 3' not-for-profit entities used by the XRB. It is estimated that fewer than 5% of incorporated societies that are not registered charities would have a statutory audit requirement[3]. The Charities Act 2005 requires registered charities with operating expenditure of $1 million or more to obtain an audit, and those with operating expenditure between $500,000 and $1 million to obtain a review.

Under the proposals, incorporated societies with annual expenditure of $2 million or less or assets of $4 million or less will be able to decide whether they would like to voluntarily have an audit or review or some other sort of engagement, like an agreed-upon-procedures engagement, to provide trust and confidence to its stakeholders such as funders.

Other enhancements

- Clarifying the role and responsibilities of officers

Incorporated societies are often reliant on volunteers to help pull together their financial information and undertake other key roles as officers. Clarifying the roles and responsibilities of officers will ensure these volunteers are able to spend their time advancing their society's purposes rather than endeavouring to understand what is required of them.

- Strengthening the provisions around conflicts of interest

Conflicts of interest are inherent within incorporated societies as it is generally those interested in progressing the society's aims who volunteer their time. The new legislation will provide guidance on the resolution of disputes, conflicts of interest, complaints and grievances.

Transitional arrangements

The draft Bill provided for a staggered application of the new regime to existing incorporated societies – a two-stage transition process over four years. It is now proposed that all incorporated societies will transition into the new regime over a single-stage two year and six month period. This would provide incorporated societies with at least two full governance cycles to make the necessary changes to their constitution required by the new Act, and to ensure all officers meet the eligibility requirements under the new Act. It would also give them the chance to re-register under the new Act (which would be actively required rather than being automatically transferred as was initially proposed).

At the end of that period, incorporated societies that have not re-registered will be de-registered by effect of the new statute. However, the new Act will provide that, if an incorporated society fails to re-register and is consequently de-registered, it can later apply to be 'restored' (as the same entity) to the new register.

As part of the transition process, the Companies Office and MBIE have committed to:

- Enhancing the Register of Incorporated Societies
- Undertaking an education campaign to let people know about the new regime.

What can we learn from the experience of registered charities?

Much can be learned from the introduction of XRB reporting requirements in the charities sector in New Zealand. A number of commonalities exist between registered charities and incorporated societies which mean that similar issues are likely to be faced. This includes raising awareness of the need to comply with the new standards and accessing competent people to help prepare the required financial and non-financial information.

One of the issues experienced by registered charities, was the need to establish whether there were 'control' relationships between their registered charity and another entity, that required financial information to be consolidated for accounting purposes. Scouts New Zealand was one such charity that had to undergo the consolidation exercise, consolidating the financial information of 391 Scout groups across New Zealand. A number of religious groups also found themselves in a similar situation. As part of the transition and re-registration process, it will be important for incorporated societies to consider whether control relationships exist between themselves and other entities (ie whether there is 'power' to control the entity and to 'benefit' from the operations). This is likely to be part of the education campaign MBIE run to let people know about the new regime.

Endnotes

[1] See MBIE project page

[2] Riordan, S., Typical Transactions in Incorporated Societies that are not registered charities, March 2016

[3] Par. 70 of the Cabinet Paper