



CHARTERED ACCOUNTANTS™
AUSTRALIA + NEW ZEALAND

31 May 2019

Charities Act Team
Policy Group
Department of Internal Affairs
Wellington 6140

Via email: charitiesact@dia.govt.nz

Dear Sir or Madam,

Modernising the Charities Act 2005

Chartered Accountants Australia and New Zealand (CA ANZ) welcomes the opportunity to provide a submission to the Department of Internal Affairs on the Modernising the Charities Act 2005 Discussion Document ("the Discussion Document"). We support this review as an opportunity to bring New Zealand's charities legislation into line with international best practice.

We have focused our feedback on key areas where we consider we can add the most value. Appendix A provides our detailed submission and Appendix B provides more information about CA ANZ.

Key Points:

- We recommend a principles-based approach is taken for revisions to the Act to allow for flexibility, adaptability and to provide long term benefits for the charities sector.
- Our members' views on the introduction of a new micro-charity tier are divided. However, if one is introduced, we recommend the threshold should include both an asset test and an operating payments test.
- We support the introduction of a requirement to disclose the reserves policy in order to improve transparency. However, we do not consider the introduction of minimum annual disbursements would be appropriate given the potential implications for charities' long-term effectiveness and sustainability.
- We consider the introduction of principles-based governance standards will help to improve sector governance, however we recommend existing requirements are also reviewed to minimise duplication.

Should you have any questions about the matters discussed in this submission or wish to discuss them further, please contact Karen McWilliams via email at karen.mcwilliams@charteredaccountantsanz.com or phone (612) 8078 5451.

Yours sincerely

Peter Vial FCA
Group Executive – New Zealand & Pacific
Chartered Accountants Australia and
New Zealand

Karen McWilliams FCA
Business Reform Leader
Advocacy & Professional Standing
Chartered Accountants Australia and New
Zealand

General comments

We support the Modernising the Charities Act 2005 review. Our members have expressed that this review presents a once in a generation opportunity and it is important that the necessary time is taken to ensure that the Act is fit for purpose and suits the different needs of New Zealand's diverse charities sector participants. In order to achieve trust, credibility, accountability and sustainability in the charities sector, we suggest that both short- and long-term measures are considered as a part of this review.

Vision and policy principles

The current Act is based on regulatory and legal requirements, which some of our members believe are too prescriptive. In Australia the *Charities Act 2013* is based on a principles model. Many of our Australian members have appreciated this approach as it means there is flexibility in application, depending on the size and type of charity. We recommend that a principles-based approach is taken when revising the Act to provide the flexibility and adaptability needed for the unique structures, funding arrangements and goals of New Zealand charities. Additionally, we consider this important to ensure that the Act is fit for purpose in the long-term, especially in a climate of rapid change and advancement in technology.

What is the role of government in achieving this vision?

Our view is that Charities Services' approach to date – providing information, support and guidance to help charities meet the requirements of the Act – has been effective and beneficial for the sector. We encourage the continuation of this vital support and education role and consider it important for Charities Services to be properly resourced and funded.

Obligations of charities

Reporting requirements

The Discussion Document notes that stakeholders have suggested a new 'micro-entity' tier be created for charities with \$10,000 or less operating expenditure and that these charities be exempted from preparing general purpose financial reports (and just file an annual return prescribed by Charities Services). It is also proposed, alternatively, that Tier 4 charities could be required to file only an annual report without an accompanying performance report. Our members have expressed mixed views on this issue. Broadly they fall into the following two positions:

1. Introduction of a micro-entity tier is a reasonable and low risk approach to improve reporting and compliance.

Some members hold the view that, whilst the four tier reporting structure is a world-leading approach that appropriately balances risk and reporting complexity, the high level of non-compliance at Tier 4 shows that reporting requirements may still create an administrative impost on a large number of very small charities. This is particularly relevant because New Zealand has a significant number of very small charities and many are staffed by volunteers with little financial expertise. Given the relatively small sums involved, these members hold the view that it would be appropriate to introduce a micro-entity tier and effectively exempt those charities from having to apply the External Reporting Board (XRB) standards, making compliance easier for very small charities.

2. Current reporting standards are appropriate and compliance is important to maintain integrity and public confidence in the sector.

Other members hold the view that the entry barrier to the charitable sector in New Zealand is low to almost non-existent. In these members' view, a fundamental question needs to be asked about the appropriateness of organisations remaining registered charities if they are not able to undertake simple cash-based accounting; this format of reporting should not be a major impost on small charities. In this view the current tiered reporting requirements are appropriate, even for the smallest charities, and the rules should not be relaxed as this would further normalise the current non-compliance. These members hold the view that charities should be held to an appropriate standard of reporting in order to retain the benefits and status of a charity and to promote public confidence in the sector.

We have not expressed a specific view on whether a micro-entity tier should be introduced. However, should such a tier be introduced, we suggest that it not be based on operating expenditure, nor on operating payments alone for the reasons outlined below.

Operating expenditure is not an appropriate basis for determining the size of a micro-entity because it includes accrual accounting concepts such as depreciation and provisions. The proposed micro-entity tier, defined on the basis of operating expenditure, would also be inconsistent with the meaning of 'specified not-for-profit entity', referred to in section 42A of the *Charities Act 2005* and defined in section 46 of the *Financial Reporting Act 2013*. This provision, which is used as part of the Tier 4 criteria, defines a 'specified not-for-profit entity' as an organisation with operating payments over \$125,000 in the preceding two accounting periods. Operating expenditure is used in section 42D of the *Charities Act 2005* as the criteria for 'large' and 'medium' charities for assurance purposes. Operating expenditure is a more appropriate basis for defining larger organisations, and operating payments is more appropriate for smaller organisations.

However, operating payments alone would not be the most appropriate way to measure a charity's size and may be misleading in certain circumstances. For example, a charity may have low operating payments but own assets of significant value. We understand that there is evidence to suggest this is the case for some charities.

We recommend that, if a micro-entity tier is introduced, an asset threshold is included in the criteria; if the charity is under both thresholds then it is a micro-entity, if it surpasses either or both of the thresholds then it must apply the XRB's Tier 4 reporting requirements.

We do not have a specific view on the appropriate level for the micro-entity tier thresholds. Should this new tier be introduced, we recommend that more research is undertaken to determine the most appropriate asset and operating payment thresholds, with specific consideration to the number of entities affected and the appropriate level of risk. Further, we note that later this year the XRB will be consulting on its post-implementation review of the accounting standards framework. Not-for-profit public benefit entity (PBE) tier size criteria is in scope of this review, and it is possible that the addition of an asset threshold to the criteria for tiers 1, 2 and 3 will be considered. In light of this, and our recommendations above for micro-entities, we recommend the definition of 'specified not-for-profit entity' be reviewed to consider introducing an asset criteria.

We also consider it important to ensure there is conceptual alignment between the reporting requirements and thresholds under the charities regulatory regime and the reporting requirements for incorporated

societies, which we understand will be addressed as part of the review of the *Incorporated Societies Act 1908*.

The Discussion Document also requests feedback on whether more support is required for charities to meet their obligations. Accurate financial reporting by charities at all tiers is critical to public trust and the integrity of the system; compliance is integral to this. In our view, non-compliance with reporting standards at the lower tiers is an issue of financial literacy and understanding in the sector. We recognise that Charities Services commits significant time and resources to assist smaller charities to meet their compliance requirements; we recommend that Charities Services considers whether the current support is sufficient and whether or not an increase in support to the sector would improve compliance.

Accumulations

We understand, from some of our members and from representatives of registered charities, that funders are increasingly looking to fund fewer charities but more deeply and over longer periods. Assessing the outcomes delivered by a charity and its commitment to financial stability and longevity are core considerations for funders. Being transparent about the purpose of accumulations can assist a charity in demonstrating its stability and effectiveness to funders, other key stakeholders and the public.

We note that charities in tiers 1, 2 and 3 are already required to report annually on the funds they have accumulated over their lives and are also required to state their reserves and describe the restrictions and/or purposes of their reserves. Our view is that there is scope to improve the narrative description of a charity's accumulation strategy, purposes and restrictions on the grounds of increased transparency and enhanced confidence in the sector. Therefore, we support in principle the proposal to require disclosure of a reserves policy, but recommend that this requirement may be better placed within the accounting standards issued by the XRB rather than legislation. (If disclosure is a separate legal requirement divorced from reporting standards, we can conceive of situations where a charity would have to disclose such a policy but have no requirement to prepare a financial report.)

We do not support a requirement for a minimal annual distribution by charities. Accumulating funds can enable charities to achieve better outcomes over a longer period, by investing in people, assets, innovation and growth. A minimal annual distribution requirement could promote 'short termism' in the sector, dis-incentivising charities from investing in the means that enable them to have a longer-lasting impact. It could also have significant undesirable effects on charities that purposefully take long-term and inter-generational views, for example iwi entities and post-settlement governance entities. If there were to be such a requirement, there would likely need to be significant exemptions and we consider that it would be hard to achieve balance and equity under such a regime.

Governance standards

In principle, we support the proposal for statutory governance standards for charities. Some of our Australian members have stated that the Australian governance principles have been useful in developing a culture of good governance and driving understanding of the purpose and outcomes of charities. We note that the duties imposed by most, if not all, of the principles-based standards in Australia would already be in place in New Zealand, under the statutory purposes and requirements in the *Charities Act 2005*, other Acts, and each charity's constitutional documents. We recommend that, if principles-based governance standards are to be introduced in New Zealand, careful consideration is given to current statutory provisions to ensure there is no confusion or conflicting duties or obligations.

Role of the regulator

We understand that Charities Services' investigation and enforcement powers are currently very limited and are not in line with regulators' powers in comparable jurisdictions. Our view is that there is a public benefit in having a regulatory body with the power to intervene if serious wrongdoing is discovered; this would help preserve confidence in the sector.

We support empowering the regulator to preserve evidence and to direct a charity to take or not take a specific action. We also support empowering the regulator to suspend or ban an officer, particularly where there is evidence of serious wrongdoing and it is in the public interest to allow the charity to continue its operations (as opposed to deregistering or suspending the charity).

Appeals process and body

The current processes of appealing and seeking judicial review in the High Court are expensive and time-consuming. An Ombudsman's investigation of a complaint about an administrative decision can also take a long time. We support the establishment of a new tribunal or a similar independent body empowered to consider appeals in a way that is quicker, cheaper, and easier to access than the High Court. Decisions of this new body should, of course, be appealable through the courts, with the District Court as the first appellate court.

Businesses

Business subsidiaries have an important role to play in ensuring the sector is sustainable. They are an increasingly important revenue source for charities, particularly in difficult funding environments and in the context of strong signals from Government to diversify sources of income. We are not aware of widespread 'rorting' of the system but our members have stated that there are isolated instances of wrongdoing, for example charities being set up to fund a business rather than supporting a charitable purpose; we support Charities Services taking stronger action against individuals and organisations involved in such wrongdoing. We note that recent changes to registration requirements for charitable businesses, introduced by the *Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019*, may go some way to addressing these issues.

Reporting

We agree that consolidated reporting of charities can result in the loss of some information that may be important for transparency, for example intragroup transactions. In principle, we support increased disclosure through improved reporting on business subsidiaries of charities. In our view, the appropriate place to address these issues is through the accounting standards issued by the XRB.

Conflicts of interest

Reporting standards do currently address related party disclosures. However, our members have stated that there is variability in how conflicts of interest and related party transactions are disclosed and, in general, they are probably not well reported across the sector. In principle we support requiring better disclosure of conflicts of interest for charities undertaking business activities.

About Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand is a professional body comprised of over 120,000 diverse, talented and financially astute members who utilise their skills every day to make a difference for businesses the world over.

Members are known for their professional integrity, principled judgment, financial discipline and a forward-looking approach to business which contributes to the prosperity of our nations.

We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that impact the economy and domestic and international markets.

We are a member of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

We also have a strategic alliance with the Association of Chartered Certified Accountants. The alliance represents 788,000 current and next generation professional accountants across 181 countries and is one of the largest accounting alliances in the world providing the full range of accounting qualifications to students and business.