Incorporated Societies Bill Consultation
Commerce, Consumers and Communications Branch
Ministry of Business, Innovation and Employment
PO Box 1473
Wellington
New Zealand

Email: societies@mbie.govt.nz

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Incorporated Societies Bill

Thank you for the opportunity to comment on the Incorporated Societies Bill.

The stated purposes of the Bill is to:

a) provide for the incorporation of societies that are carried on for lawful purposes other than financial gain; and
b) provide a legislative framework that promotes high quality governance of societies; and
c) promote accessibility to the law of societies by providing a comprehensive legislative framework; and
d) recognise the principles that—
    (i) societies are organisations with members who have the primary responsibility for holding the society to account; and
    (ii) societies are private bodies that should be self-governing and free from inappropriate Government interference; and
    (iii) societies should not distribute profits or financial benefits to their members.

We make specific comments below on matters raised by the Consultation Draft. In this submission we utilise research funded by Victoria University and the External Reporting Board (XRB) that investigated incorporated societies that are not registered charities. We consider that this group is the focus of any new financial or assurance requirements. Hence we refer to research undertaken on these particular entities, particularly the 42% of those with expenditure <$10,000.

From the financial reporting viewpoint we agree with the Consultation Draft of the Incorporated Societies Bill that all incorporated societies should be required to report under formal reporting standards. While very small incorporated societies may argue that they should not have to follow prescribed XRB accounting standards, we believe there are real benefits in societies maintaining accounting records that are comparable and robust. Thus there could be benefits in the XRB undertaking a post implementation review of its Tier 4 standards to ensure they are readily used by smaller charitable entities and (in the future) incorporated societies that are not registered charitable entities.

We understand that further recommendations will be released by the Ministry of Business, Innovation and Employment on:

1) Assurance-related matters[1]; and
2) Revised set of standard provisions[2]

We trust that these recommendations will be widely circulated for public consultation, particularly the standard provisions that are the core foundation of ensuring high quality governance of incorporated societies.

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[1] Exposure draft, paragraph 106, page 18.

[2] Exposure draft, Annex paragraph A1, page 30.

The views expressed in this submission are our own personal views and do not necessarily reflect the views of our universities, or two of the authors memberships on the New Zealand Accounting Standards Board and the New Zealand Auditing and Assurance Standards Board.

Yours sincerely,
Withheld

Carolyn Cordery PhD MCA BBS FCA FCPA
Associate Professor
Victoria University of Wellington
Email: carolyn.cordery@vuw.ac.nz
Withheld

Rowena Sinclair PhD MPET BCom CA
Accounting Researcher
Withheld

Withheld

Cherrie Yang PhD MPBS PGDipAcc BBIM
Lecturer
Auckland University of Technology
Email: cherrie.yang@aut.ac.nz

GENERAL COMMENTS:

There are three matters of general comment. First on research conducted on the Register of Incorporated Societies on Incorporated Societies that are not registered charities. Then on the Exposure Draft (ED) comments on assurance and the standard provisions for constitutions.

(1) Research on Incorporated Societies that are NOT Registered Charities[3]

From the research we have undertaken (sponsored by the External Reporting Board and Victoria University), we are able to make some observations on the Incorporated Societies database. We note that the research analysed only Incorporated Societies that are **not registered charities** and for this submission, we provide analysis of the entities that had annual expenditure of less than $2,000,000. That is, they were in the equivalent of tiers 3 and 4 of the current XRB regime as applies to registered charities. The methodology is attached as an Appendix. As a random sample, this represents 1.7% of the population of incorporated societies that are not registered charities as at August 2015.

Our research showed that the vast majority (**90%**) of incorporated societies that are not charities are **small tier 4 entities**. Only **9% of the incorporated societies** are tier 3 and less than 1% of incorporated societies are tiers 1 & 2. When compared to registered charities, where 74% are in tier 4, there is a larger percentage of incorporated societies that are not charities that are small. Further, 28% of tier 4 incorporated societies that are not charities have expenditure between $0 and $5,000 (and 15% have expenditure between $5,000 and $10,000). In fact, just over 50% of the incorporated societies sampled had an annual expenditure of less than $15,000. This is a general trend throughout the tier, with the number of incorporated societies represented in each expenditure bracket falling as the expenditure increases. Although not as pronounced, this same trend can also be seen in registered charities.

The number of incorporated societies using cash or accrual reporting was examined. In order to determine whether financial statements were prepared using a cash or accrual basis, the notes accompanying the financial statements were examined, along with the presence of items such as deprecation, debtors and creditors. It was found that 42% of tier 4 incorporated societies report on a cash basis. However, only 1.4% of tier 3 incorporated societies report on a cash basis. Of all cash reporters, 35% reported in a manner that would be readily convertible to the current tier 4 standards for charities (that is, they presented an income and expenditure statement, a list of assets and liabilities and included notes to the accounts).

The research shows that the **mean expenditure** of all incorporated societies that are not charities using cash accounting was **$16,938.22**. The standard confidence interval for the mean has an upper bound of $24,360.89 and the data suggest that most (**80%**) of the incorporated societies currently using cash accounting incur a total expenditure of **less than $20,000**.

Expenditure	Incorporate Societies that are NOT Registered Charities	Registered Charities
All Tier 4 entities	90%	74%
Very low expenditure levels $0 to $10,000	42%	29%
Low to mid-range expenditure levels $40,000 to $65,000	10%	21%
Average annual expenditure of Tier 4	$27,661	$34,288

Table 1: Some Tier 4 Expenditure levels comparisons

[3] We acknowledge the March 2016 research done by Scott Riordan (under the supervision of Associate Professor Carolyn Cordery), and the assistance with statistics from Dalice Sim.

As Table 1 shows, at very low expenditure levels (0-10,000 dollars) there is a larger number of tier 4 incorporated societies (42%) compared to tier 4 registered charities (29%). In contrast, only 10% of tier 4 incorporated societies had low to mid-range expenditure levels (40,000-65,000) compared to 21% of tier 4 registered charities. Thus, not only is there a higher percentage of tier 4 incorporated societies compared to charities, incorporated societies within tier 4 also tend to be smaller in size. This is supported when comparing the average total (annual) expenditure of tier 4 incorporated societies and charities, as this is 24% higher in charities ($34,288 compared to $27,661).

Nevertheless, while the very small incorporated societies may argue that they should not have to follow prescribed accounting standards, we believe there are real benefits in societies maintaining accounting records that are comparable and robust. The analysis shows that 35% of those already doing cash reporting do so in a manner that is readily convertible to tier 4 standards. However, there could be benefits in the XRB undertaking a post implementation review of its Tier 4 standards to ensure that they are readily used by smaller charitable entities and (in the future) incorporated societies. The research that they sponsored is a start to this process.

(2) Exposure Draft – Auditing or Review (paragraphs 106-108)

Charities Act 2005 section 42D Factual error

We would like to highlight the error of fact in the ED (paragraph 107, page 18) which states “section 42D of the Charities Act 2005 (annual revenue of $500,000 in both of the last two financial years)”.

> *Charities Act 2005 42D Meaning of large and medium size*
>
> *(1) In section 42C,*
>
> ***(a)*** *a charitable entity is* ***large*** *in respect of an accounting period if, in each of the 2 preceding accounting periods of the entity, the total operating expenditure of the entity and all entities it controls (if any) is $1 million or more:*
>
> ***(b)*** *a charitable entity is of* ***medium size*** *in respect of an accounting period if—*
>
> ***(i)*** *it is not large under paragraph (a); and*
>
> ***(ii)*** *in each of the 2 preceding accounting periods of the entity, the total* ***operating expenditure*** *of the entity and all entities it controls (if any) is $500,000 or more:*

Detailed above is the extract from the Charities Act 2005 that identifies the measurement basis is operating expenditure not annual revenue. This is because as with incorporated societies the focus for registered charities is on what they do i.e. expenses, rather than what assets they have control over or the revenue they receive.

The need for some form of assurance

We agree with ED paragraph 109 that it is likely that the funders of incorporated societies (e.g. philanthropic organisations and government agencies) rather than the entity will drive the decision on assurance. However, ED paragraphs 107 and 108 shows that tax exemptions, as the reasoning for registered charities being accountable, do not apply to many societies, so the assurance requirements can be loosened. We do not agree with this viewpoint for the following reasons:

Many societies also have income tax exemptions even when they are not registered as charities. For example, section CW 44 of the Income Tax Act 2007 outlines that an amount of income derived by a friendly society is exempt income, in which the society can be registered as incorporated societies. Moreover, many incorporated societies are entitled to tax benefits other than income tax exemption, such as, a Fringe Benefit tax on non-cash benefits paid to their employees, and donee status. Therefore, incorporated societies that are not registered charities are also accountable to their stakeholders e.g. their funders and members. This highlights a need for some form of assurance from the societies.

We also refer to the XRB/Victoria University research already mentioned, where it was found that the number of incorporated societies that are not registered charities having review engagements was low across all tiers. The frequency was highest in tier 4 incorporated societies (12%), followed closely by tier 3 incorporated societies (10%) and was absent altogether in tier 1 & 2 incorporated societies. In contrast, the frequency of audits rose sharply as the tier size increased (88% in tier 1 & 2, 59% in tier 3 and 23% in tier 4). Indeed, as the incidence of audit was noted only where an audit report was also lodged and some incorporated societies recognise audit costs but do not file audit reports, it is likely that the incidence of audit is higher.

It is important that appropriate guidance is provided for incorporated societies that are not registered charities that enables them to balance the costs and benefits of audits and reviews. As highlighted in page 3, these entities are relatively smaller in size, they are thus more likely to be influenced by their funders regarding the decision on assurance. In this case, the extent to which the assurance driven by funders meets the needs of members may require further consideration and discussion.

(3) Exposure Draft – Annex pages 30-36: Standard provisions for constitutions (clauses 33 and 34)

The Consultation Draft has missed the opportunity to provide standard provisions on: (1) no financial gain; and (2) location of Registered office. This should be amended and, especially with respect to "no financial gain" be robust.

INCORPORATED SOCIETIES BILL - SPECIFIC CLAUSES:

As per the ED request we have included comments on specific clauses in clause order. However, where there are several clauses on the same topic we have grouped these clauses together

Clause 2 Commencement: *Transitional arrangements around branches*

The transitional arrangement around branches (ED paragraph 16, page 7). We do not agree that Incorporated Societies with branches can be 'grandfathered' into the new arrangements under provisions written in 1920. It is very important for financial reporting purposes that an Incorporated Society decides where control lies and whether or not branches form a group. Currently there are many examples on the Register where branch financial transactions are not included in group accounts which are therefore lacking and would not comply with current Generally Accepted Accounting Practice. It therefore follows that all Incorporated Societies should be required to reconsider their structures in re-registering.

Clause 24(1)(m) Contents of constitution: Nomination of a NFP entity for distribution of surplus assets

Comment included under Clause 161(2)

Clause 83 Annual financial statements must be prepared and registered

What is meant by "registered?"

Clause 83 does not specifically detail what constitutes "registered". As per Clause 83(3) does the act of giving the financial statements to the Registrar constitute registered, or does the Registrar register the financial statements by uploading to the Register?

Who monitors the Financial Statements and tracks who lodges? If it is the Registrar has this been factored into their budget? We note that the Registrar has not been very active in the past and with new regulation, monitoring should increase if it is to be effective.

Clause 85 Annual returns

Who checks that the information is in the "prescribed manner"? If it is the Registrar will they be funded for this, or will the technology be funded to do a rudimentary electronic check?

Clause 129 Grounds for removal from register

Does Clause 129 include not filing Annual Return or 'registering' Financial Statements?

Clause 146(3) Approval of amalgamation proposal: "simple majority"

How do you stop divisive interests? As with Clause 168(1) prefer 75% majority rather than "simple majority" as concerned that interest parties/members could amalgamate an Incorporated Society on the ulterior motives of 50.1% of the members. 75% is clearer as it constitutes a substantial majority.

Clause 161(2) Division of surplus assets on winding up

To stop divisive interests this should be 75% majority rather than a 'simple majority' or at the discretion of the Officers.

Also relevant for Clause 24(1)(m) Contents of constitution: Nomination of a NFP entity for distribution of surplus assets.

Clause 168(1) Approval of resolution: “simple majority”
As with Clause 146(3) prefer 75% majority rather than “simple majority” as concerned that interest parties/members could close down an Incorporated Society on the ulterior motives of 50.1% of the members. 75% is clearer as it constitutes a substantial majority.

Clause 172(1)(d) Contents of register: Names of the officers
As per ED paragraphs 155-157 do not like Options B or Option C. Given that Clause 173 allows the Registrar discretion to restrict public access. Transparency of officers is the best sunlight.

Clause 180(c) Functions of Registrar: Receive financial statements, annual returns
Clause 180(c) details that the Registrar ‘receive’ the financial statements and annual return. Who will monitor the financial statements for appropriateness i.e. includes necessary information? Note the comments above about the need for monitoring if the new regulation is to be effective.

Clause 189 Share of information relating to charitable entities
This is an excellent idea which has worked well in the past.

Appendix: Methodology[4]

This data was taken from a random sample of incorporated societies taken from a list of all currently registered incorporated societies (obtained from the Ministry of Business, Innovation and Employment) as at 7 August 2015. To ascertain the non-charity population of incorporated societies, a copy of the charities register was downloaded from DIA Charities Services as at 29 July 2015 for those entities that had filed annual returns in the year. The two register files were compared based on matching the incorporated society number. The random sample of the population of incorporated societies that are not registered charities (17,031) was extracted in ten groups of 300, where each group of 300 was randomly extracted from the whole population.

Taking this file, the incorporated societies' website (www.societies.govt.nz) was used to access the accounts of the randomly selected incorporated societies. Each incorporated society on the list had its accounts examined, those that filled the sample criteria were selected for further analysis. The criteria was to have 145 incorporated societies that are not charities from Tier 4, Tier 3, and no fewer than 10 from Tiers 1 or 2. Any society that had not filed a report on or after the 31st March 2014 was excluded from further analysis, as were any societies that had no transactions other than those relating to bank fees or interest. This required inspection of the annual operating expenditure of 2,021 societies. For the purposes of this study, incorporated societies were deemed to be tier 4 if they had an expenditure less than $125,000, tier 3 if they had expenditure between $125,000 and $2,000,000 and tier 1 & 2 with expenditure greater than $2,000,000. These are the same thresholds currently in place for registered charities. All incorporated societies in the final data set were checked against the charities register to ensure no charities that are also incorporated societies were included in the analysis.

The sample size (145 tier 4, 145 tier 3 and 10 tier 1 & 2) was selected based on assumptions made about the incorporated societies register from the charities register, that 3.5% of the population falls into Tier 1 or 2, and 3.5% of 300 is 10 entities. In the event, incorporated societies are smaller than registered charities and this may have resulted in over-sampling these larger entities, especially as, in the event, 16 tier 1 & 2 entities were selected out of 306 in total.

[4] Methodology extracted from XRB report by Scott Riordan available at https://www.xrb.govt.nz/Site/Research/Research_Reports.aspx