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Commercial, Consumers & Communications Branch  
Ministry of Business, Innovation & Employment  
Wellington

Via email: [societies@mbie.govt.nz](mailto:societies@mbie.govt.nz)

## Submission regarding Exposure Draft Incorporated Societies Bill

Thank you for the opportunity to provide comments on your Exposure Draft regarding the Incorporated Societies Bill. Attached are our comments from our review of the proposed legislation.

We are aware that the MBIE intends to publish submissions on your website. We have no issue with this.

Any questions with regard to this submission should be referred to the writers Craig Fisher & Wayne Tukiri via (09) 367-1656 or [craig.fisher@rsmnz.co.nz](mailto:craig.fisher@rsmnz.co.nz) or [wayne.tukiri@rsmnz.co.nz](mailto:wayne.tukiri@rsmnz.co.nz)

Yours sincerely



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## About RSM in New Zealand

RSM in New Zealand is a leading provider in audit, tax and consulting services to commercial organisations, public sector entities, as well as having a specialisation in providing audit and assurance and services to the not-for-profit/charitable sector.

The RSM New Zealand group consists of the business advisory and tax operation, RSM New Zealand, and specialist audit and assurance firm, RSM Hayes Audit. With 17 partners and 135 staff we operate from offices in Newmarket, Albany, Highbrook and Manukau. RSM in New Zealand is proudly NZ owned and operated and rebranded under a single RSM brand in October 2015.

While based in Auckland we act for clients nationwide. In addition, RSM is a leading member of the NZ CA network of 29 accounting firms throughout New Zealand.

RSM in New Zealand is a member of RSM International - the sixth largest international accounting network of independent audit, tax and consulting firms in the world.

RSM Hayes Audit is our dedicated audit practice, led by six specialist audit partners and currently has a full time specialist audit team of approximately 50. We are a registered audit firm under the Auditor Regulation Act 2011 and currently have 6 licensed auditors. Our audit client base essentially represents a snap-shot of the New Zealand economy ranging across most sectors and entity types. This currently includes a range of smaller issuers, numerous SMEs, large private entities, state sector entities and a significant number of not-for-profit and charitable entities. Our audit client base includes experience with a considerable number of incorporated societies of differing types and sizes.

At RSM, we have taken and continue to take an active involvement in standard setting in New Zealand with one of our audit partners being the former chair of the New Zealand Institute of Chartered Accountants Professional Standards Board and representing New Zealand internationally in assurance standard setting. He is now a member of the NZAuASB.

## Background context regarding Incorporated Societies

Our views in this submission have been formed largely from our direct involvement in assisting clients over many years who are incorporated societies and other stakeholders in matters relating to incorporated societies. Our client experience covers both for-profit and not-for-profit incorporated societies, with the latter being by far the larger group. Quite a number of the incorporated societies we deal with are also registered charities.

RSM (and via our former firm Hayes Knight Audit) has been actively involved in publicising developments and providing education in the area of incorporated society law reform since the Law Commission review process into the 1908 Act was commenced. RSM's involvement has included providing education via seminars, workshops, and article writing. Many of these articles can be found by searching incorporated societies on our website [www.rsmnz.co.nz](http://www.rsmnz.co.nz). We have also been involved in assisting incorporated society clients on a one on one basis, as well as to national groups of incorporated societies, when they have been considering entity restructuring matters and the like.

## Overarching Observations

We strongly agree with and applaud the overhaul and modernising of this area of law in New Zealand. While the Incorporated Societies Act 1908 has served us extraordinarily well as a country over its very long existence we agree with the Law Commission about this being “uncomfortably old” and as such not well placed to best serve New Zealand civil society into the future.

Specifically, we have seen examples of some very poor behaviour within the operation of incorporated societies that we believe should be able to be avoided by greater clarity in the law, for the benefit of those organisations, and New Zealand society in general. This is especially regarding the areas of disputes within incorporated societies, and financial reporting.

However, given the incredibly wide diversity of size, type, complexity, and resources of incorporated societies operating in New Zealand we do not underestimate the considerable practical challenges that a complete overhaul of this area of law will impose of some entities. Incorporated societies in New Zealand range from very small simple single purpose clubs to large very complex trading concerns such as some trade associations, examples such as the Automobile Association or Southern Cross Healthcare, and everything in between.

From our experience with assisting incorporated society clients we have found vastly different levels of ability to respond to such changes. This is both in terms of understanding, resource and capacity within organisations, as well as the capacity of those within organisations to accept and cope with change more generally. As an observation compared to other types of legal entities, we often note a stronger desire of incorporated societies to hold on to past history and approaches, and a greater reluctance to investigate new ways of achieving their aims.

Hence we suggest it is important that there continues to be good communication and education to the sector regarding the required changes. In this regard, the more that MBIE can do to assist co-ordination of other sector stakeholders who can assist with this, the better.

## Specific Observations

### 1. Proposed accounting for incorporated societies

We strongly concur with the proposal that the legislation should require all incorporated societies to comply with the financial reporting framework developed by the Government’s accounting and audit standard setter, the External Reporting Board (XRB) for Public Benefit Entities.

New Zealand has recently gone through a hugely significant overhaul of its financial reporting framework with a lot of expertise being applied to this process. This has resulted in a two sector, multi-tier accounting standard framework. The benefit of having sector and entity size appropriate accounting standards that are considered generally accepted accounting practice (GAAP) will, we believe, bring significant benefits to the sector as a whole as regards transparency, accountability, understandability and comparability.

Previously incorporated societies, in most cases, were not required by law to comply with GAAP. Due to this lack of requirement under the incumbent 1908 Act to follow GAAP the result has been a hugely variable quality of financial reporting by incorporated societies. Sadly, much of the financial reporting for incorporated societies has been of very poor quality, and at times we believe used to deliberately mask poor behaviour, and to ensure a lack of transparency. This is not helpful for readers of this financial information.

Given that approximately 35% of incorporated societies are also registered charities they are already required by law to comply with the appropriate XRB accounting standards. Given that these are now sector and size appropriate in New Zealand we think this proposal for all in the sector to follow XRB issued standards is appropriate and eminently sensible.

We think that this initiative will be beneficial for the whole sector and all stakeholders interested in it as it should result in financial reporting that:

1. is cost appropriate relative to the incorporated society size
2. will result in greater consistency and transparency of financial reporting and hence comparability between entities
3. provides comparability between registered charities and NFP incorporated societies given that they are often seeking funding from the same sources
4. better enables accounting providers and software providers to assist the market with standard models etc
5. restricts the different varieties of accounting ensuring that “generally accepted accounting practice” is true to its name.
6. will ensure consistency of accounting treatment within groups that may have a combination of registered charities and incorporated societies that are not registered charities

Good accounting assists in achieving appropriate accountability.

## 2. Small Societies Exemption

We are aware of calls from some parties, such as Hui e, for very small incorporated societies to be exempt from financial reporting requirements due to this being a disincentive for them to form and hence an impediment on civil society. While we can appreciate the point of view, we do not agree with it. Our concerns are that:

1. as accountants and auditors, we commonly see poor financial behaviour leading to problems and disputes within incorporated societies
2. the tier 4 XRB standards for the smallest of entities are a very simple form of cash accounting. Essentially these require a record of receipts and payments and some other very basic information in a specified format and for which models and explanatory guidance exists. If entities are not able to comply with this very basic level of recording, then to us it raises a serious question as to whether it is appropriate for them to be in charge of finances of a legal entity on behalf of others?
3. Legal structure is a privilege providing various benefits and protections, and a choice. As such we see a basic level of financial accountability and transparency as a quid pro quo for this privilege.

Accordingly, we are not convinced that there should be exemptions from the financial reporting requirements.

## 3. Proposed public filing of financial statements

Both the incumbent and the proposed new legislation require incorporated societies to file their annual financial statements on the public register. We think this makes sense as regards ease and cost-effectiveness of access to annual financial statements by the society’s members, and others who may be interested in them as an entity with legal structure and protections.

We also think it important given the crossover of incorporated societies that may also be registered charities that the proposed new legislation also clarifies that if the incorporated society is required to file its financial statements by some other legislation, such as the Charities Act 2005, then it will only have to file on one public register. The linking of this information within various Government databases should be an issue for Government and not the incorporated society.

#### 4. Audit requirements

We note that, similar to the incumbent 1908 Act, there is no legislated mandatory audit or assurance requirement proposed for incorporated societies under the Bill.

Obviously if an incorporated society is also a registered charity, and it meets the assurance thresholds under the Charities Act, then it must comply with that legal assurance requirement. However, this is in its capacity as a registered charity and not merely as an incorporated society. There may also be other less common legislation that may impose an audit requirement on some incorporated societies due to their activities. For example, if a society was running a retirement village or otherwise was considered a Financial Markets Conduct (FMC) Act reporting entity then it would need to comply with the financial reporting and assurance requirements of that applicable legislation. We do however expect the number of such cases to be relatively small in the population of NZ incorporated societies.

The audit requirement has been well debated and we believe that the right landing place has been reached given that, unlike registered charities that are accountable to wider society due to their tax exemptions, most incorporated societies are only accountable to their members. Also taken into account is that audit or other assurance, done properly, comes at a cost. This cost has also increased in recent years as the professional standards that auditors are required to follow have continued to evolve and impose a greater level of mandatory requirements upon any audit or review.

If legislation requires independent assurance, then we believe it is important it is done properly in accordance with recognised standards and by appropriately qualified people. Accordingly, similar to the situation with registered charities, we would expect this would specify that any independent assurance requirement be provided by appropriately qualified assurance providers. This may have cost and access to independent assurance implications.

Hence we believe it should be a matter for the members to decide if they believe that the cost of assurance is justified, or alternatively if they are happy not to require independent assurance.

We suspect that many incorporated societies will still voluntarily choose to require independent assurance over their annual financial statements under any new legislative regime. This may be influenced by such factors as the number of members, the types and level of assets & liabilities and activity of the particular society. We suggest that may be a valid and sound governance decision. But the key is that it should be a positive decision rather than just a default position....and this is especially the case for small incorporated societies where the audit cost will likely be a proportionally greater expense due to their small size.

#### 5. Financial Gain

We concur with the general principles regarding financial gain and prohibiting members from benefiting other than via normal employee relationships or arms-length transactions or similar. In our experience this has been an area of some dispute and allegations in incorporated societies.

However, some existing incorporated societies, especially those with large trading operations to support their purpose, do currently pay some of their senior employees' bonuses, or other incentive payments related to financial performance and meeting or exceeding budgets. Their rationale as we understand it is that they seek to operate their trading operations as effectively as possible and to ensure they achieve their commercial aims and financial results.

Additionally, incorporated societies with large trading operations are also competing with the commercial sector for skilled employees and hence competing with bonus and other remuneration practices to be able to attract and retain these employees.

Hence on our interpretation of the Bill as it is presently drafted, it would appear that this practice may now be under threat. This could be seen as a significant impediment for a small number of large incorporated societies currently.

We also observe increased interest in entities in the NFP sector to develop and be involved in social enterprise as a means to financially support their aims. There also appears to be an increasing number of innovative models being developed in this regard. Hence we suspect there may be more pressure on this Financial Gain issue.

## 6. Amalgamations & Financial Gain

Given our experience in recent years with groups of struggling entities seeking more sustainable models, we expect that there will likely be more amalgamations of incorporated societies in future. This is especially in relation to national groups of incorporated societies where incorporated societies may be members of each other, or at least of the national body. It is also likely to apply where a cause may have one or more incorporated societies as well as other related entities such as charitable trusts and foundations.

Our concern stems from the prohibition from any distribution going to members on the basis of Financial Gain potentially stopping a sensible amalgamation or restructure of entities into a new more sustainable entity structure.

Accordingly, we think it important that clause 22(1) be amended to permit distribution to a “member” in an amalgamation circumstance, as long as this does not infringe against the general no Financial Gain principle.

## 7. Amending Constitutions (27)

Given the importance of the Constitution we believe consideration should be given to requiring more than by a “simple majority of members participating and voting.” Or at least it should be clear that a society can choose to have in its Constitution a higher threshold than a simple majority. We think that it may also be beneficial to further clarify the terms participating and voting in that it is not clear to us if that means being present and if so how proxies fit into that.

## 8. Officers duties

We pass on a general observation and concern that has been expressed to us from a number of existing officers of incorporated societies that they perceive that their duties may have significantly increased under the proposed Bill.

Our view on discussing this with officers who have raised the issue with us is that the draft Bill largely codifies and clarifies existing officer duties in one place, rather than this being a significant increase. Likewise, it appears to us to provide greater clarity about what is expected good governance. Accordingly, we support the codification and clarification of officer duties and believe that this should better assist officers in understanding and performing their roles.

## 9. Contact Officer (s43)

We have received some comments of concern and general confusion about the role of the Contact officer. Perhaps this could be alleviated by further clarifying or defining this person’s role. i.e. why they would be contacted etc.

Our understanding is that this role is designed to be a contact point for communications and providing information about an incorporated society to authorities. If this is correct then we also question why a Contact Officer would necessarily need to be a member of the committee? In large incorporated societies the most appropriate person to carry out this role would probably be the General Manager or CEO or similar of the organisation, who would not normally be a committee member.

## 10. Information for members (s71)

We believe that access to information for members is too wide as drafted and may be problematic as regards disagreements. We have seen many examples of members “with an axe to grind” and a lot of time on their hands causing incorporated societies considerable time and effort because the governing body has not agreed with their view and they are unwilling to drop the issue. As such we believe that

this section may result in incorporated societies being seriously tied up in terms of time and resources in responding to requests for information.

While we appreciate paragraph 4 giving a society the ability to refuse to provide information we are unsure how effective this will be in practice. Specifically, what is considered “frivolous and vexatious” by one member may be completely different to how another member views this.

We have had the above concerns expressed to us by a number of people involved with incorporated societies as well.

### **11. Balance Date (s 81)**

We note that across the population of NZ incorporated societies there is a range of balance dates throughout the year for a variety of reasons. We believe this flexibility is appropriate. However, given the importance of the balance date to financial reporting we believe this is something that should probably be specified in the constitution or otherwise decided by the membership. That is, we believe it is not something that should be able to be changed at will, say just by a decision of the committee.

### **12. Register (s170)**

Given the commonality of incorporated societies and charities, increasing similarity of reporting requirements, and the desire for efficiency in Government we wonder if perhaps consideration should be given to a joint register in future for charities and incorporated societies, and possibly any other form of NFP with legislative requirements.