

VNZ Submission on the Incorporated Societies Bill

TO:	Volunteering New Zealand members.	DATE:	17 June 2016
FROM:	Matthew Magner, Policy Advisor. Scott Miller, Chief Executive.	STATUS:	For feedback from members.

1. EXECUTIVE SUMMARY

Volunteering New Zealand (VNZ) conditionally supports the introduction of a new Incorporated Societies Act.

VNZ does have issues with the Incorporated Societies Bill (the Bill) in its current form, and VNZ recommends that the Bill be altered so as to assist in the good governance of incorporated societies in New Zealand.

Key points in this submission from VNZ:

1. The Bill is an attempt to professionalise the process by which incorporated societies are governed and managed.
2. If done appropriately this process will benefit the incorporated society sector, bringing societies in to line with principles of good governance in New Zealand.
3. The Bill in its current form goes too far in imposing obligations on incorporated societies in New Zealand. The new requirements will be onerous for many societies, and this may prompt many existing incorporated societies to reconsider their legal status.

2. CONTEXT

The Government, through the Ministry of Business, Innovation and Employment (MBIE), has released an exposure draft of the Bill. The Bill is based on the findings of the Law Commission, as set out in the Commission's report "A New Act For Incorporated Societies". Once passed into law this bill will replace the Incorporated Societies Act 1908 (the Act).

As a piece of legislation the Act has served New Zealand well. It has been in force for 108 years, and during that time it has provided the legal framework for a large number of community organisations. However it is recognised in the sector that Act is no longer adequate in providing this legal framework. It has been surpassed by modern technology, and does not reflect current good governance and accounting practises.

There are approximately 97,000 not for profit organisations in New Zealand, which contribute 2.6% to the national GDP, or 4.6% when volunteer labour contributions are taken into account. 90% employ no staff and as such they rely solely on the work done by volunteers in order to operate. Of these 97,000 organisations, incorporated societies make up 22%; or approximately 22,700 not for profit organisations that are classified as incorporated societies and therefore use the Act as their legal framework.¹ The conclusions that can be drawn from this are as follows:

- There are a large number of volunteers in incorporated societies operating in New Zealand, and if taken as a whole these organisations manage (through both revenue and expenditure) a significant amount of money.
- The size of this sector determines that incorporated societies play an important role in New Zealand communities, with organisations ranging from sporting bodies to community support groups.
- As an organisation VNZ is committed to the promotion, support and representation of volunteers and volunteering in New Zealand.² As most incorporated societies are made up of dedicated volunteers, VNZ supports the political and social issues which affect them.

The Bill aims to provide clear legal guidance for the governance of incorporated societies in New Zealand. The Law Commission recognises the need for this due to the important role incorporated societies play in New Zealand, and the inadequacy of a 108 year old act in providing this guidance in contemporary New Zealand.

3. KEY POINTS TO THE CHANGE OF ACT

The overall purpose of the Bill is to professionalise the process through which incorporated societies are governed and managed.

3.1 KEY PRINCIPLES

The Law Commission established the following as guiding principles for the Bill:

¹ *Typical Transactions in Incorporated Societies that are not Registered Charities*, Scott Riordan from Victoria University, 2016.

² VNZ Constitution

1. Societies are organisations run by their members, and those members have the primary responsibility for holding their societies to account.
2. Incorporated societies should not distribute profits or financial benefits directly to members (who join to achieve a shared purpose, not for personal financial profit from the activities of the society).
3. Societies are largely private bodies that should be self-governing and free from inappropriate state interference.
4. The legislative regime should be flexible, to suit the purpose of the incorporated society sector, which is made up of many diverse organisations which should be able to govern themselves with proper regard to their purpose and culture.³

3.2 CHANGES TO THE LAW

These principles are meant to be the basis for the recommendations of changes in the Law Commission's exposure draft of the Bill. The key changes to the Act are as follows:

1. **Pecuniary gain.** A society cannot have as its primary purpose the goal of making money. As such any distribution to members of money or assets is now expressly prohibited. However an incorporated society is permitted to generate income in order to fulfil its purpose. Members can also be reimbursed for reasonable expenses, and providing benefits to members would be acceptable under the Bill.⁴

This is an important change to the Act. It is a necessary change as the current law allows money making activities that run counter to the purpose of a society. Although these can be considered 'unethical', they are not illegal. It reflects the principle that incorporated societies exists solely for the fulfilment of a purpose or mission, and that money making activities should occur in support of this purpose.

An example of unethical pecuniary gain would be for members to benefit from an incorporated society which is asset rich, yet with a declining membership and poor governance structure. Examples of this can include such techniques as above market remuneration for services or below market asset sales. Now this would be illegal.

2. **Membership.** The minimum membership requirement is now set at 10, down from 15. This enables an incorporated society to operate with more flexibility as it is less likely to be

³ *Overview of Proposed New Incorporated Societies Act*, Bannister & von Dadelszon, 2015.

⁴ *The Purpose of your Incorporated Society – Can it make money? And who can it take home?*, Craig Fisher from RSM New Zealand, 2016.

restricted by minimum membership requirements. This reflects the reality of the incorporated society sector, which includes many small organisations.

3. **Limitation of member liability.** Individual members of an incorporated society will now not be liable for a society's legal obligations. This provides a similar protection for what members of for-profit organisations enjoy under the Companies Act 1993.
4. **Society constitutions.** Incorporated societies are now required to have a constitution; including such provisions as the purpose of the society, a registrar of members, how societies control and manage their finances, and arrangements for general meetings. Standard form provisions will be provided by the MBIE for the Bill, from which an incorporated society can choose the provisions that are appropriate for their organisation.
5. **Contact Officer.** Incorporated societies will be required to have a contact officer, with whom the Registrar can communicate if necessary. For VNZ's position of this requirement please see under the heading "Issue with the Bill".
6. **Conflicts of interest.** Officers of a society, who have a financial interest in a matter relevant to a society, must declare conflicts of interest and will be not be able to participate in votes in pertaining to that matter.
7. **Society committees.** The new Act will make it mandatory for incorporated societies to have a committee responsible for the affairs of a society. Compulsory constitutions (see above) must include guidelines by which these committees operate (such a committee's roles and functions). This will require committee members to consider their new obligations in light of the purpose and mission of the incorporated society.
8. **Annual financial reporting.** All incorporated societies will be required to prepare annual reports and file them with the Registrar. These reports must meet the standards of Generally Accepted Accounting Practises (GAAP) in New Zealand, as determined by the External Reporting Board (XRB). Incorporated societies will have the same financial reporting requirements as registered charities, bringing the sector in line with the practise of other organisations in New Zealand. Currently 8500, or 35% of incorporated societies, are also registered charities, and as such already filling reports that adhere to these standards.

The XRB reporting standards consist of both financial and non-financial components. Financial requirements include a profit and loss balance sheet, while non-financial requirements include a statement of service performance.

This change to the Act is consistent with the Government's position on the not-for-profit sector. New Zealand is a signatory to the Financial Action Task Force (FATF), which is an intergovernmental body that sets standards to combat international money laundering and terrorist financing. FATF's Recommendation 8 requires member states ensure their laws

prevent not-for-profit organisations from financing terrorism. By holding incorporated societies to the XRB standards, the government hopes to meet their obligations to FATF.⁵

9. **Enforcement and sanctions.** Members, or former members, of an incorporated society will be able to apply to a court for orders to enforce a society's constitution. The Registrar will also be able to apply to a court for a society's constitution to be enforced, if it is in the public interest and in the interest of the society itself.

4. ISSUES WITH THE BILL

4.1 FINANCIAL REPORTING STANDARDS

The main issue at stake in the Exposure Draft of the Bill is the requirement of all incorporated societies to provide annual reporting in accordance with all of the accounting standards issued by the XRB. This will result in the adoption of a four tier system of financial reporting:

- Tier 1 which will cover organisations with more than \$30 million in operating expenses.
- Tier 2 which will cover organisations with under \$30 million operating expenses.
- Tier 3 which will cover organisations with under \$2 million operating expenses.
- Tier 4 which will cover organisations who have combined annual operating payments under \$125,000.

The requirement for incorporated societies to adhere to the XRB reporting standards is part of the Law Commission's commitment to providing guidance in good governance for the sector. This commitment to a professionalisation of the sector is appropriate for many incorporated societies. Societies that have obligations to external stakeholders should be held to the XRB standards. With good accounting comes appropriate accountability. This would be a good thing for many societies as it will increase public trust in the sector. Following the current reporting standards as set out by the Act has meant much of the financial reporting in the sector has been poor.⁶

VNZ Position

VNZ contends that the requirement that all incorporated societies be obligated to adhere to all, both financial and non-financial components of the XRB standards, is not appropriate. This is due to the diverse nature of incorporated societies in New Zealand.

Many incorporated societies are only reporting towards their members, and have limited or no external stakeholders. 90% of incorporated societies would be tier 4 organisations in the XRB four tier system, and 50% of incorporated societies have an annual expenditure of less the \$15000, and 42%

⁵ *Kiai To Financial Crime Body: Foster Civil Society As A Partner, Not An Enemy, In The Fight Against Terrorism*, Maina Kiai as the Special Rapporteur on the rights to freedom of peaceful assembly and of association, 2016.

⁶ *The Purpose of your Incorporated Society*.

have an expenditure between \$0 and \$10000.⁷ Societies such as these include wine societies, small suburban squash clubs, or community support groups that arrange annual lunches. It would not be appropriate for these very small societies to be required to meet the same reporting standards as registered charities. Only a small percentage of the income of would-be tier 4 organisations comes from the public (3% from fundraising and 14% from donations and grants). Income generated from revenue from goods and services offered, or sourced through the membership fees constitute the bulk of funding for these societies (62%). The smaller an incorporated society is, the less likely it is to owe obligations to the general public.

Requiring a very small incorporated society to submit items such as statements of service performance is an onerous expectation that is only appropriate for larger, more professional organisations. It is an unreasonable emphasis on outputs and outcomes that is not appropriate for this part of the sector. Restructuring the entire incorporated societies sector merely in the pursuit of professionalisation is dogmatic. The legislative approach should be to enforce change where it is necessary; a practical basis for change and not an ideological one. Many incorporated societies are not driven by performance, nor do they see measuring their performance as a priority. It is enough for them to exist, and to function as they see fit. It is through this approach that they best serve New Zealand's communities. When it is not in the public interest for them to do so (as it would be for a charity or a large incorporated society who owes an obligation to the public), it would be unreasonable for them to be forced to do so.

Mandatory XRB reporting standards would be an unnecessary burden on small incorporated societies who are not registered with the Registrar of Donee Status, or a registered charity. Such organisations do not gain the same benefits of being publically accountable (for example tax exemptions), so should not have the same measure of mandatory compliance costs.

The law changes should help promote the incorporated society sector, and not unduly hamper it. Incorporated societies should not be discouraged by imposing requirements they could not hope to meet. This undermines civil society by creating a disincentive to forming these organisations, which provide many and varied benefits to their communities. Fundamentally it is a breach of the freedom of peaceful assembly and association, which should be possible without unnecessary compliance costs. There is also the risk of increased cases of non-compliance, which will undermine the objective of Law Commission to provide a robust legal framework for the sector.

4.2 CONTACT OFFICER

The second issue that is raised by the Bill is that of the requirement for every incorporated society to have a contact officer with whom the Registrar may communicate, and that the contact officer must be a committee member to be eligible. This is part of the Law Commission's aim to professionalise the sector by holding societies more accountable.

VNZ Position

⁷ *Typical Transactions in Incorporated Societies that are not Registered Charities.*

As it stands the Bill breaches the Law Commission's principle to protect incorporated societies from undue State interference. The requirement of the contact officer being a member of the committee would interfere with the day to day running of an incorporated society, many of which are large organisations and rely on outsourcing executive functions to professionals who are either third party contractors, or paid employees. This should be a legitimate approach to the running of an incorporated society.

5. RECOMMENDATIONS

1. Requiring an incorporated society to submit an annual report that adheres to the XRB reporting standards, when it has an annual expenditure of less than \$15,000, is simply not appropriate. VNZ recommends that the new Act should require all incorporated society to adhere to the financial reporting standards. Accounting for profit and loss is a simple and reasonable requirement.

The Act currently requires all incorporated societies to provide a profit and loss balance sheet. If VNZ's recommendations are followed the new Act will not introduce a radically different obligation on very small incorporated societies. This is an appropriate level of scrutiny for incorporated societies that only owe an obligation of oversight to their members. If the membership simply wishes to see their society's money has come from and been spent, why should there be a more stringent requirement to adhere to GAAP?

This requirement on very small incorporated societies will do nothing to ensure the government meets its obligations towards FATF. Although there could be some benefit in ensuring that organisations within the incorporated society sector do not launder money and finance terrorism, holding very small societies to the XRB standards would do nothing to help New Zealand meet its obligations towards FATF. Considering that very small societies make up a large percentage of the sector overall, the potential negative impact on civil society must be considered when the final version of this Bill is written.

It is important to remember that if a society which is not of donee status and has a small annual expenditure, can always choose to follow the more stringent requirements of the XRB reporting standards. The Bill will still be providing a framework for the good guidance of incorporated societies, as well as be consistent with the government's position on the not for profit sector. However it will not unduly hamper the sector with mandatory compliance costs.

2. The new Act should not set out the requirements for a society's contact officer. Although there should be a general obligation for a board or committee of an incorporated society to maintain overall responsibility for the running of an incorporated society, the Bill should stop there in its guidelines. Provided a society can provide appropriate oversight of its functions, it should not be a specific requirement that a contact officer be a member of the society's committee. Third party or non-member employees can provide this oversight.

3. VNZ supports the Law Commission’s move to professionalise the incorporated society sector, provided this is done for the benefit, and not to the detriment, of the sector. The impact of the new requirements (as set out above under the heading “Key Points to the Change of Act” will be that societies now have a framework to help them set out the day to day rules by which they operate. This will help incorporated societies to operate with the same good governance and consistency that organisations such as registered charities and companies operate with, and as such bring them in line with the general practice in contemporary New Zealand. If done correctly the changes to the Act are potentially an exciting opportunity to help grow New Zealand’s civil society.

The attempt of the Law Commission to provide an operational framework for the incorporated society sector is most clearly illustrated by the new requirement for incorporated societies to have in place a standard process for dispute resolution. This provides both protection for individual members, as well as a means of holding members to account when it is appropriate to do so.

6. KEY CONTACTS

Withheld