GUIDANCE FOR NOT-FOR-PROFIT FINANCIAL REPORTING IN NEW ZEALAND

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About this publication

This publication has been developed to help practitioners understand and effectively implement the new accounting standards framework for not-for-profit entities.

The publication is intended to be read in conjunction with any relevant legislation, the entity's founding documents, and the accounting standards. It provides helpful information and examples only.

WHAT IS A NOT-FOR-PROFIT ENTITY?

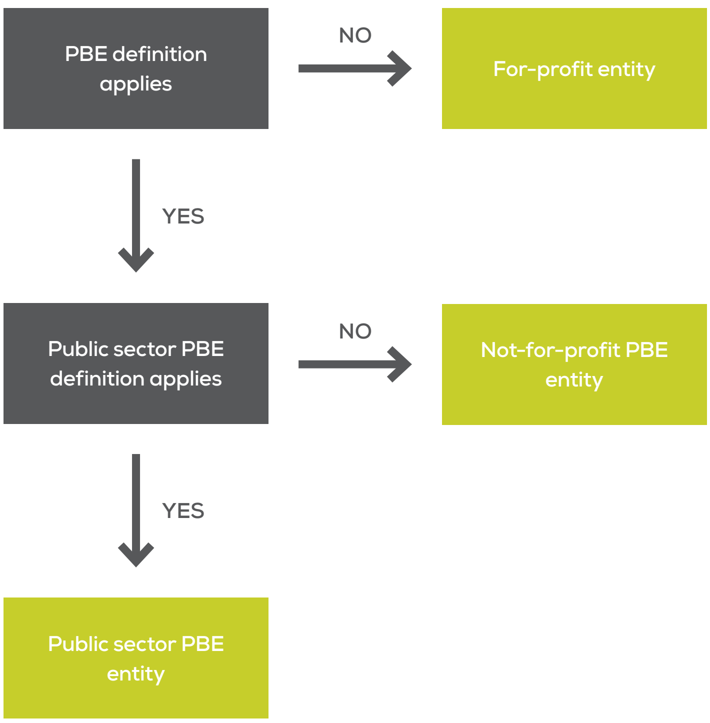
Not-for-profit (NFP) entities are constituted in many different forms such as incorporated societies, charitable trusts and companies. The form of an entity does not in itself determine whether an entity is a NFP for the purpose of financial reporting.

The accounting standards issued by the External Reporting Board define a **not-for-profit public benefit entity (NFP PBE)** is an entity that is a **public benefit entity** that is not a **public sector entity.**

Public benefit entities (PBEs) are reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.

Public sector public benefit entities (public sector PBEs) are PBEs that are public entities as defined in the Public Audit Act 2001, and all Offices of Parliament.

The decision tree below helps an entity decide what type of entity it is for financial reporting purposes. Appendix A of Standard XRB A1 *Application of the Accounting Standards Framework* provides further guidance on how an entity determines if it is a PBE for the purpose of financial reporting.



TIP:
This guidance only applies to NFPs. If an entity does not meet the definition of a PBE then it is a for-profit entity, and this guidance does not apply.

FINANCIAL REPORTS

Requirements for a NFP to prepare a financial report can be found in a number of places, including but not limited to:

- The legislation that the entity is subject to (otherwise known as 'statutory' requirements)
- The entity's founding documents (ie rules, constitution or trust deed)
- A funding application or funding agreement.

TIP:
An entity can change the requirements in its founding documents to align them with the statutory requirements.

Appendix 1 provides an overview of the legislated financial reporting provisions that might be applicable to the NFP sector.

TIP:
An entity can be subject to more than one piece of legislation (ie an incorporated society can also be a registered charity). If this is the case, then the highest legislative requirements apply.

When it comes to financial reporting, there are some terms used in legislation that need to be explained.

Firstly, an entity is a 'specified not-for-profit entity' in respect of an accounting period if, in each of the two preceding accounting periods, its total operating payments are $125,000 or more[1].

Secondly, 'generally accepted accounting practice' ('GAAP') and 'non-GAAP' refer to the accounting standards issued by the External Reporting Board (XRB)[2] or its sub-board the New Zealand Accounting Standards Board (NZASB).

Finally, 'general purpose financial reports' (GPFR) are financial reports that are intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs. 'Special purpose financial reports' (SPFR) are often described as financial reports that are prepared to respond to the requirements of users that have the authority to require the preparation of financial reports that disclose the information they need for their particular purposes.

TIP:
SPFR are prepared in accordance with the accounting policies agreed between the entity and specific users. They may or may not be prepared in accordance with the accounting standards issued by the XRB or NZASB. Ethically, Chartered Accountants should not knowingly prepare SPFR if they believe the financial report will be used for general purposes.

[1] Section 46 of the Financial Reporting Act 2013

[2] See xrb.govt.nz for standards and guidance

ACCOUNTING STANDARDS

The XRB has developed an accounting standards framework for NFPs that have a statutory requirement, or that choose to prepare financial reports in accordance with standards issued by the XRB. Standard XRB A1 *Application of the Accounting Standards Framework* outlines how to apply this framework.

There are four tiers of reporting for NFPs in the accounting standards framework. In general, the accounting standards become progressively simpler as the entity moves down the tiers. As there is a significant variation in the size of NFPs, the tier structure allows charities to apply accounting standards that are appropriate to their size and complexity.

Tier 1 is the default tier for all NFPs. However, an entity may elect to apply the accounting standards of a lower tier if it meets the criteria for that tier. Likewise an entity can also remain in a higher tier than it is eligible to report under if it so chooses.

The criteria for each of the tiers is based on annual operating expenditure or payments (including grants made), and whether the entity has 'public accountability'. Public accountability has a particular technical meaning here which is narrower than everyday usage. This is when an entity holds cash or assets on behalf of others as one of their main activities. This is typically the case for banks, credit unions and insurance providers.

The accounting standards framework for NFPs is shown in the table below.

Tier	Criteria	NFP accounting standard(s)
1	"Public accountability[3]"; or expenses >$30m	PBE Standards
2	No public accountability; and expenses ≤$30m	PBE Standards – Reduced Disclosure Regime (RDR)
3	No public accountability; and expenses ≤$2m	PBE Simple Format Reporting Standard – Accrual (SFR-A (NFP))
4	No public accountability; and payments <$125k*	PBE Simple Format Reporting Standard – Cash (SFR-C (NFP))

*For the two preceding accounting periods

The tier 1 and 2 PBE standards consist of 38 separate standards derived largely from International Public Sector Accounting Standards (IPSAS). Tier 2 entities are generally subject to the same recognition and measurement requirements as tier 1 entities but are allowed to take advantage of significantly reduced disclosure requirements.

The tier 3 accounting standard is based on a simple format reporting approach using accrual accounting. This appropriately reflects the small size and reduced level of complexity within many entities in this tier, as well as the needs of the users of these entities.

The tier 4 accounting standard also uses a simple format reporting approach, but it uses cash accounting and is even simpler than the tier 3 standard as tier 4 entities are very small.

TIP:
Both the tier 3 and 4 standards are accompanied by an explanatory guide containing optional templates and guidance notes[4] to assist with application.

[3] Public accountability is defined in paragraphs 7–13 of **Standard XRB** A1 *Application of the Accounting Standards Framework*
[4] EG A5 (for Tier 3) and EG A6 (for Tier 4)

The accounting standards for tiers 1, 2 and 3 are GAAP standards and fair presentation frameworks because they are based on accrual accounting. Entities in tiers 1, 2 and 3 are also 'specified not-for-profit entities'.

The accounting standard for tier 4 is a 'non-GAAP' standard and is a compliance framework because it is based on cash accounting. Entities in tier 4 are not 'specified not-for-profit entities'. This is particularly relevant if an entity's founding documents make reference to GAAP, as this will preclude it from using the tier 4 accounting standard even if it meets the criteria.

Entities that are allowed by law to use the tier 4 cash accounting 'non-GAAP' standard are:

- Registered charities
- Maori incorporations
- Friendly societies

Many people find the terms 'accrual' and 'cash' accounting confusing when they first start dealing with finances.

In **accrual accounting**, revenue is recognised when it is earned rather than when it is received, and expenses are recognised when they are incurred, rather than when they are paid.

With **cash accounting**, transactions are recorded on the date the money was paid or received. At its simplest, cash accounting uses the receipt book and bank deposit details to track income and the cheque book or electronic banking payment details to track expenditure.

TIP:
Accounting concepts such as depreciation are not used with cash accounting.

Appendix 2 provides some illustrative examples of the application of the accounting standards framework.

APPENDIX 1 – LEGISLATIVE REQUIREMENTS

Entity form	Legislative reference*	Financial reporting requirement
Body corporate	s32 of the Unit Titles Regulations 2011	Financial statements … contain the matters: i. a statement of assets and liabilities; ii. a statement of income and expenditure; iii. any other matters that the body corporate decides by ordinary resolution should be included in the financial statement; and iv. any explanatory material that the body corporate considers necessary for the purpose of understanding the financial statement.
Charitable trust	Charitable Trusts Act 1957	None
Class 4 gambling licence holder	s108 of the Gambling Act 1993	An annual report must include … financial statements prepared in accordance with generally accepted accounting practice.
Credit union	s122 of the Friendly Societies and Credit Unions Act 1982	Every entity must ensure that … financial statements that comply with generally accepted accounting practice are … completed.
Friendly society	s63–64 of the Friendly Societies and Credit Unions Act 1982	Every registered society or branch must ensure that … financial statements are …completed. The financial statements must be prepared in accordance with: i. in the case of a specified not-for-profit entity, generally accepted accounting practice; or ii. in any other case, either generally accepted accounting practice or a non-GAAP standard. Registered societies or branches with expenses <$30m can opt-out by a resolution passed by a ≥50% majority vote of the members.
Incorporated society	s23 of the Incorporated Societies Act 1908	Every society shall deliver … to the Registrar … a statement containing the following particulars: i. the income and expenditure of the society during the society's last financial year; ii. the assets and liabilities of the society at the close of the said year; iii. all mortgages, charges, and securities of any description affecting any of the property of the society at the close of the said year.
Industrial and provident society	s8D of the Industrial and Provident Societies Act 1908	Every registered society … must ensure that … financial statements that comply with generally accepted accounting practice are … completed. Registered societies with expenses <$30m can opt-out by a resolution passed by a ≥95% vote of the members.
Maori incorporation	s276A of the Te Ture Whenua Maori Act 1993	The committee of management of every Maori incorporation must … submit … financial statements … The financial statements must be prepared in accordance with: i. in the case of a specified not-for-profit entity, generally accepted accounting practice; or ii. in any other case, either generally accepted accounting practice or a non-GAAP standard.
Registered charity	s42A of the Charities Act 2005	The financial statements … must be prepared in accordance with: i. in the case of financial statements of a specified not-for-profit entity, generally accepted accounting practice; or ii. in any other case, either generally accepted accounting practice or a non-GAAP standard.
Trust	Trustee Act 1956	None

*References are correct at time of going to print

APPENDIX 2 – ILLUSTRATIVE EXAMPLES

1 – A trust

It has annual operating payments of less than $125k for the years ending 31 March 2014 and 31 March 2015. It has no public accountability. It meets the definition of a NFP.

The following is an extract from its trust deed: *"The charitable trust must prepare annual accounts that comply with GAAP".*

Although the Trustee Act does not require the preparation of financial reports, it is required to prepare GPFR by its founding documents so this prevails.

Although the trust meets the criteria to be in tier 4, the tier 4 accounting standard is non-GAAP. So the trust can only elect to move down to tier 3 at a minimum, and it can apply PBE Simple Format Reporting Standard – Accrual for the year ended 31 March 2016.

2 – An incorporated society with a class 4 gambling licence

It has annual operating expenses of $5m for the year ended 30 June 2016. It has no public accountability. It meets the definition of a NFP.

Although the Incorporated Societies Act does not require the preparation of GPFR, the Gambling Act does require the preparation of GPFR so this prevails.

The incorporated society meets the criteria to report under Tier 2 so it can apply PBE Standards (RDR) for the year ended 30 June 2016.

3 – A charitable trust that is also registered charity

It has annual operating payments of less than $125k for the years ending 31 March 2014 and 31 March 2015. It has no public accountability. It meets the definition of a NFP.

Although the Charitable Trusts Act does not require the preparation of financial reports, the Charities Act requires the preparation of GPFR so this prevails.

The charitable trust meets the criteria to report under tier 4, and is allowed under the Charities Act to use a non-GAAP standard, so it can apply PBE Simple Format Reporting Standard – Cash for the year ended 31 March 2016.