

## Consolidations – an accounting or a strategic issue?

*We've previously advised that consolidations of entities for accounting purposes is likely to be one of the more challenging aspects of complying with the new mandatory accounting standards. While the accounting concept and mechanics need working through, it is perhaps more important and possibly more beneficial to consider this issue from a strategic viewpoint. This article explains.*

### An accounting consolidation may be required

The new Public Benefit Entity (PBE) accounting standards require the consolidation of financial statements of any entities considered controlled for accounting purposes. These new accounting standards are mandatory for all registered charities. In addition, with the revocation of the old accounting standards these new PBE standards now represent generally accepted accounting practice (GAAP). Hence any entity required or wishing to comply with GAAP, for example to provide maximum credibility to funders and other key stakeholders, will want to follow these.

As we have previously written (see <http://www.rsm.global/newzealand/news/groups-and-consolidations-new-financial-reporting-standard-challenges-charities>) this new accounting standards requirement will require PBE organisations to go through a careful and thorough assessment process of related entities to determine if they do in fact meet the definition of being controlled under the accounting standards.

We have also suggested that this assessment be done well in advance of the year-end annual financial statements preparation process. The key reasons being that:

1. The control/consolidation assessment process can be complex and take time, for example getting all relevant information required to make an accurate assessment.
2. It involves discussions between governing bodies and management of more than one entity.
3. It is an additional task for the finance team.
4. If consolidation of financial statements are required then there can be quite a lot of practical logistics and alignment issues to be worked through such as:
  - a. Differing balance dates
  - b. Differing accounting systems
  - c. Differing accounting treatments in different entities
  - d. Differing charts of accounts
  - e. Possibly more entities to be included in the annual audit process

From initial accounting standard control assessments that we have been involved in assisting PBE clients with, there are quite a lot of controlled entities that will require consolidated financial reporting for the first time.

### The current NZ situation – We've got lots of small entities!

Our not for profit and charitable sector in New Zealand consists of a large number of entities. Over 27,400 registered charities (and growing of late). Add to that at least 24,000 incorporated societies of which 2/3rds are not registered charities, plus a host of other entities. Best estimates are that we have over 100,000 PBEs in New Zealand. That's a heck of a lot for a country of just 4.6m people!

To give these numbers some relativity, if you just look at our population of registered charities; we have approximately twice the number of these on a per capita basis compared to our cousins across the ditch in Australia. Go further afield to the more mature charity market of the United Kingdom and we have nearly 3 times as many on a per capita basis as they have.

We are extremely good in New Zealand at starting small entities. Sadly we also appear to be very good at keeping many of them small.

While not wishing to make any sort of value judgement on the worth of these entities, the fact that we have so many small entities results in a disproportionate amount of administration and compliance compared to the overall amount of service that all of these entities are delivering.

When we've made this statement in the past we've often caused considerable reaction. And mostly adverse reaction. We've been called corporate and uncaring (and some stronger words too!). We're told we don't understand the sector and what drives it, and that you can't apply corporate thinking to the PBE sector.

However, looking at this from a purely resource usage perspective; a population with such a large number of small entities means that more resources, financial and otherwise, are being spent on admin and compliance activity, rather than whatever it is that the organisations exist for.

One of the most common criticisms we get is that "We don't understand." Apparently we especially don't understand "what drives the people in the sector that set up and run these organisations." "Nor how hard and passionately they work."

Now at this point your authors (being human too) occasionally react. We like many kiwis are also personally involved in some PBE organisations in our "spare time". We do understand the passion, commitment, time, and just plain hard work that are involved.

But we are yet to meet any volunteers, even accountants and auditors, that jump up in the morning saying; "I just can't wait to spend some time in compliance and administration for our (*enter your respective charity or NFP entity name here!*)"

Add to this an increasing focus from many of the donating public wanting to ensure that their money donated is going direct to the cause, and not the administration of the cause.

## An example

Let's take a common scenario to explore this further. Imagine a national charitable cause; say an age related health cause. Its genesis dates back 50+ years. The national structure currently consists of 35 separate incorporated societies geographically spread around the country. All with a similar purpose to address the same cause, yet all separate legal entities with their own separate governance and all the administration and compliance effort and costs that go with that. They try and coordinate some activities nationally but things like personal politics and parochialisms often get in the way. Many struggle financially. Tragically they also often burn out members who put in huge hours and effort to try and keep it all going. And even after all that donated time and effort feel that their organisation is still not delivering as much of their service as it should.

Sound familiar? Well if you take a look though our PBE sector in New Zealand it should. There are literally hundreds of similar scenarios. At a personal level it's really sad. At an objective organisational strategy level it is a highly inefficient use of resources.

## A possible solution?

A single organisation model where there is one centralised efficient function that delivers all the activity that can be done centrally e.g. admin, accounting and audit, legal compliance, possibly national fundraising etc. However 34 geographically spread delivery units. This is an opportunity to use cost-effective technology such as cloud computing to solve the previous tyranny of distance. Previously physical geography was the reason in many cases why we have so many separate legal entities for the same cause nationally.

If you were starting most of these organisations today from a blank sheet of paper you would never create 35 separate ones.

Rather than this being about taking away entity sovereignty, this is about a redistribution of effort and resources. The volunteers who were getting burnt out by having to do everything in their organisation, including lots of admin and compliance they didn't enjoy, can instead focus their energies on the cause and service delivery. Take away their pain, focus them on why they are there; the cause.

Yes there will be a sense of loss of control (ironic that in an article about accounting control), but to be able to deliver more, more efficiently, to more people should make up for that perceived loss of control.

And the interesting thing about control that many are so focused on not wanting to lose; to be in control of a struggling organisation isn't much fun anyway!

This isn't easy to achieve. But it is simple.

## Parting thoughts

So there you have it. For those brave enough to fight the usual predictable adverse reaction against change, and to negotiate the politics; a possible opportunity to simplify.

By the way; we're ready for the usual criticisms that it's much more complex than this, and that we don't understand. But we don't buy that.

In the words of an old Persian saying; *All things are difficult before they become simple.*

Or if that doesn't work for you, how about this from a very successful kiwi bloke; *Take a teaspoon of concrete and get on with it!*



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