Is your charity ready to comply with the new accounting standards?

Effective 1 April 2016 New Zealand's charities regulator has a new role – monitoring and checking compliance with the new mandatory financial reporting standards. So how is the DIA Charities Services likely to approach this?

The background to the changes

As we have previously written; our charitable sector in New Zealand consists of a large number of entities. Over 27,500 registered charities, and growing of late. Importantly for this large group their world has changed significantly in 2016. Unless they have been living under a rock, all 27,500 of these registered charities should now be aware that they are now required by law to comply with the relevant tier of Public Benefit Entity (PBE) financial reporting standards as issued by the External Reporting Board (XRB).

The XRB's PBE financial reporting standards are themselves effectively legal instruments. Hence charities are now required by law to comply with standards that are themselves law. This is quite a significant change from the past situation when most charities had no requirements imposed on them to comply with any form of generally accepted accounting practice (GAAP). While many did comply with the then GAAP, or at least had an honest attempt at compliance, there was no compulsion. An implication of this was that for charities that didn't like some accounting treatment they could not be forced to follow GAAP. They always had the option of special purpose reporting. The flow on implication of this was a considerable amount of variety of accounting treatment and financial reporting, and the resulting loss of the benefits of comparability and general understandability.

Fast forward to the legislative reforms regarding charities in New Zealand from 2005 onwards and it was decided that if a charity is to gain the considerable benefits of registered charity status then a quid pro quo for that would be being mandatorily required to follow GAAP. However also recognised was the very different sizes and complexity of our charities in New Zealand. Hence GAAP for them consists of 4 tiers of financial reporting standards – essentially different levels of complexity for different sizes of charities. (Ok for all you accounting train spotters out there – Tier 4 isn't technically considered GAAP but the standards for Tier 4 are still specified by the XRB and required to be followed).

Especially relevant to 2016 is that this is the year that all charities are required to comply with the new financial reporting standards.

But hey! Isn't this all just additional compliance? Why make it hard for charities?

This is a comment we have heard from a number in the sector. And yes this is additional compliance.

But it's also needed if we are to continue to engender trust in, and support for, the charitable sector in New Zealand. Frankly there's little point in enforcing transparency of a charity's financial information if there are no standard rules to be followed and everyone does their own thing. Essentially that's been the situation with the charities register to date; it's a great up to date register, but sadly the financial information on it has been highly variable, and much of it of very poor standard. ("Rubbish" is the technical accounting term for some of it!).

Understandability and comparability are key features of transparency. The new PBE standards will assist greatly with this.

For those charities that remain unconvinced and still want to complain about the effort of compliance then the ultimate answer is simple: *No-one is forcing you to be a registered charity*. It's ultimately your choice. There are clear advantages to being a registered charity such as the income tax exempt status and public credibility. And if an entity wants to avail itself of these potentially considerable advantages then there will be some compliance required. Quite simply this compliance is the “tickets to the game”.

What’s the regulator likely to do?

We’ve had informal discussions with the team at DIA Charities Services with regard to the potential sector challenges posed by the transition to the new accounting standards. And especially how some entities will handle some of the more challenging and judgemental issues - such as assessment of controlled entities and consolidation.

While the DIA are unsurprisingly circumspect in their comments, lest this be seen as a formal public statement of their position, the following is a summary of relevant points and observations as we understand them:

1. They are the charities regulator and are required by law to ensure that registered charities are meeting their reporting requirements. From 2016 this includes compliance with mandatory accounting standards.
2. Their primary sanction for non-compliance is de-registration of a registered charity. This has potential implications for the previously registered charity of:
    a. A loss of income tax exempt status
    b. A loss of their donee status - meaning donors can no longer claim a personal tax rebate
    c. Tax assessment of the asset base within the deregistered charity in accordance with IRD guidelines
    d. Potential adverse public perception and other funder impact if no longer a registered charity
3. The practical reality is that there are over 27,500 registered charities and this is a new requirement for the sector. It is also a sector characterised by much volunteer input and hence it is expected there will be resource challenges in the sector in getting up to speed, and complying, with the new accounting requirements.
4. DIA Charities Services also has their own practical resource constraint as regards their capacity to check all registered charities financial statements for accounting standard compliance.
5. DIA Charities Services has an educative aspect of their role and assisting understanding of and compliance with legislative requirements is part of that. They recognise that this will be a learning process for all involved. Their approach is not to punish honest attempts at compliance. However, understandably they will have to take action on wilful non-compliance.
6. DIA Charities Services are already well aware of some of the more difficult accounting areas. For example, they recognise that accounting consolidation is one of, if not the, most difficult area to be grappled with for some charities with the adoption of the new accounting standards. They recognise that it is complex even for accounting professionals.
7. Their message to charities as regards grappling with technical accounting issues is essentially: seek appropriate advice (would expect that to be professional advice for large and complex questions), be guided by that advice, and then the charity governing body make their considered decision and report on this basis. Importantly, clear disclosure of any such judgemental decisions and the basis for these should be made in the financial statements of the charity.
8. DIA Charities Services overall aim is appropriate public transparency of charities and to ensure completeness of information.
9. DIA Charities Services may take action if they disagree with a charity’s assessment of an accounting matter.

Summary

So can charities take from this they can ignore or not worry about understanding and grappling with these new accounting standard issues? Absolutely not!

And like any regulator DIA Charities Services will no doubt come down hard on wilful non-compliance - and so they should to protect the integrity and support of all other charities.

Instead the expectation is that charities facing transition to the new PBE standards will take a diligent approach to their understanding of the new requirements, seek appropriate expert assistance in scoping the requirements of the new standards, and in applying them to challenging or judgemental areas. The governing bodies of charities should make informed decisions accordingly, as well as clearly documenting and disclosing such judgements made in the process in their financial statements for transparency.

All in all, a very common sense, pragmatic and helpful approach in our view.

About the Authors

Craig Fisher FCA is an Audit Partner and Chairman of RSM. Craig is a specialist regarding not-for-profit and charitable entity issues.

Contact Craig on:
D: +64 (9) 367 1654
E: craig.fisher@rsmnz.co.nz
W: www.rsmnz.co.nz

Jason Stinchcombe CA is an Audit and Technical Partner at RSM and provides advice regarding complex accounting matters including the transition to the new PBE Standards.

Contact Jason on:
D: +64 (9) 367 1658
E: jason.stinchcombe@rsmnz.co.nz
W: www.rsmnz.co.nz