

A step back in time

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1908 was a great year for New Zealand. The first passengers travelled by train on the North Island main trunk line, the legendary Edmonds Cookery Book was published and New Zealanders competed in the Olympic Games for the first time.

As we discussed previously, 1908 was also the year our Incorporated Societies Act was introduced. This Act has governed the operation of incorporated societies for the last 111 years!

As I'm sure you'll agree, much has changed in the world since 1908, and the Government has decided that the 1908 Act needs modernising to ensure it keeps up to speed with these changes.

Financial reporting requirements

Government have introduced the following three criteria to determine which incorporated societies will be required to reporting using standards issued by the External Reporting Board (XRB). The requirement will be required for societies that have one or more of the following:

- annual payments of \$10,000 or more; and/or
- assets of \$30,000 or more; and/or
- “donee status” under the Income Tax Act 2007.

In our view the above criteria should help ensure small incorporated societies are not disproportionately burdened by the need to comply with these requirements. Research on incorporated societies undertaken in March 2016 found that 42% of entities had expenditure of less than \$10,000. As such, setting the threshold at \$10,000 is likely to remove the requirement to prepare financial statements in accordance with XRB standards for almost half of New Zealand's incorporated societies.

Assurance requirements

Under the 1908 Act, there was no requirement for incorporated societies to obtain an audit or review of their financial information. The initial Incorporated Societies Bill was silent on whether or not an audit or review was required. In our view, given the separation between “owners” (ie members) of societies and their governing body, and their ability to benefit from a range of tax exemptions, it is sensible to require larger incorporated societies to obtain some form of assurance to discharge their accountability.

The recently released amendments propose a mandatory audit requirement where incorporated societies, who are not registered charities, satisfy one of the following criteria:

- annual expenditure over \$2 million; or
- assets over \$4 million.

The Charities Act 2005 requires registered charities with operating expenditure of \$1 million or more to obtain an audit, and those with operating expenditure between \$500k and \$1 million to obtain a review (ie lower thresholds for registered charities). We understand the rationale for this is in part due to the range of tax incentives available for registered charities and their ability to seek funding directly from the public.

Under the proposals, societies with annual expenditure lower than \$2 million or assets less than \$4 million will be able to decide whether they would like to voluntarily have an audit or review or some other sort of engagement, like an agreed-upon-procedures engagement, to provide assurance or other information to its funders and other stakeholders. In practice, it is often the funding agencies that require entities to obtain an audit. Education is underway to let funding agencies know about the other options available to them to confirm receipt and appropriate use of their funding.

It may be worth considering whether it is necessary for societies with less than 10 members to require an audit (in the same way as companies with less than 10 shareholders are not required to comply with financial reporting or audit requirements) or whether an ‘opt out’ mechanism could be introduced for societies with more than 10 members (as per section 206 (1) (d) of the Companies Act 1993).

Transition arrangements

It is proposed that all incorporated societies will transition into the new regime over a 2 ½ year period, with all incorporated societies being required to re-register under the new Act

(rather than being automatically transferred as was initially proposed). The Bill is expected to be introduced into Parliament later this year.

As part of the transition process, the Companies Office and MBIE have committed to:

- enhancing the Register of Incorporated Societies
- undertaking an education campaign to let people know about the new Incorporated Societies regime.

What can we learn from the experience of registered charities?

Much can be learned from the introduction of XRB reporting requirements in the charities sector. A number of commonalities exist between registered charities and incorporated societies which mean that similar issues are likely to be faced. This includes raising awareness of the need to comply with the new standards and accessing competent people to help prepare the required financial and non-financial information.

One of the issues experienced by registered charities, was the need to establish whether there were 'control' relationships between their registered charity and another entity, that required financial information to be consolidated for accounting purposes. Scouts New Zealand was one such charity that had to undergo the consolidation exercise, consolidating the financial information of 391 Scout groups across New Zealand. A number of religious groups also found themselves in a similar situation. As part of the transition and re-registration process, it will be important for incorporated societies to consider whether control relationships exist between themselves and other entities (ie whether there is 'power' to control the entity and to 'benefit' from the operations). This should be part of the education campaign MBIE run to let people know about the new regime.

We strongly support the introduction of enhanced reporting and assurance requirements for incorporated societies and encourage those leading the transition to consider the recent experience gained from introducing these requirements to registered charities in New Zealand. In our view, communication and education is the key to a successful transition to ensure incorporated societies are able to continue to operate within and contribute to our society for the next 111 years.

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