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WEEKLY COMMENT: FRIDAY 24 MAY 2013

1. In *Weekly Comment* 19 April 2013 I discussed the Financial Reporting Bill. The Bill was reported from the Commerce Committee on 22 May. The changes are not huge: interested readers are referred to the Bill as reported. The key changes relate to registered charities and other not-for profit entities. Therefore, I thought it appropriate to use this opportunity to also discuss the audit proposals for charities released by the Ministry of Business, Innovation & Employment in February 2013.

2. But first, a brief summary of the changes in the Financial Reporting Bill as reported:

   (a) An exemption in clause 44 for inactive companies from the requirement to prepare financial statements. An entity will be inactive if it has not derived any income during the period, and has no expenses for the period, and has not disposed of, or been deemed to have disposed of, any assets.

   (b) Various changes to reporting deadlines:

      (i) Under clause 86, entities that are not FMC reporting entities will have 5 months from balance date in which to prepare financial statements (rather than 3 months in the Bill as introduced). There is a similar change for overseas companies and other companies with significant overseas ownership.

      (ii) Bringing forward the reporting deadline for issuers and other FMC reporting entities from 6 to 4 months after balance date has been retained. However, most other proposed changes to deadlines in the Bill as introduced have been reversed, restoring the deadlines that currently appear in the applicable Acts, or replacing with 5 months existing deadlines that are too short, too long, or unspecified.

   (c) Clause 86 has been amended so as to limit the requirement for an overseas company or group to prepare financial statements for its New Zealand business if that business is not "large" (under the test in clause 44 – that has not changed from the Bill as introduced).

   (d) An audit exemption has been introduced for a large company that is a wholly-owned subsidiary of a company that has complied with requirements to lodge group financial statements.

   (e) Minority shareholders of companies that are not reporting entities will have the right to obtain financial statements prepared for tax purposes.

   (f) Clause 106 has been amended to ensure that a registered friendly society or branch can only opt out of preparing financial statements if a majority of its members vote, as opposed to simply a majority of those present at a meeting.

(g) Clause 145 has been amended to allow the partners of limited partnerships that are not large to choose to prepare and distribute financial statements and undertake an audit. (The Bill as introduced did not provide this option.)

Increased accounting threshold for not-for-profit entities

3. The Commerce Committee has recommended amending clause 45 to increase the threshold at which a not-for-profit entity must prepare financial statements on an accrual basis rather than a cash basis from $40,000 to $125,000. The Committee believed that $40,000 is too low, as many smaller charities above this threshold do not have the capacity to prepare accrual-based financial statements.

4. In *Weekly Comment* 19 April I discussed, from paragraph 26 onwards, the new reporting requirements for registered charities. I noted that the XRB has released for comments proposed standards for Tier 3 and Tier 4 NFP entities. The revised cash/accrual threshold will mean that the Tier 3/Tier 4 threshold will change along the same lines.

5. The specific threshold, as set out in clause 45 of the Bill as reported, is that in each of the 2 preceding accounting periods of the entity, the total operating payments are $125,000 or more. This means that:

(a) NFP entities with operating payments of less than $125,000 per annum will be in Tier 4 and the corresponding accounting standard will be a simple format standard – cash basis.

(b) NFP entities with operating payments of $125,000 or more, but less than $2 million will be in Tier 3 and the corresponding accounting standard will be a simple format standard – accrual basis.

(c) NFP entities with operating payments of $2 million or more, but less than $30 million will have the Reduced Disclosure Regime apply to them.

(d) NFP entities with operating payments of $30 million or more will have the full Public Benefit Entity accounting standards apply to them.

Auditing requirements for charities

6. In April 2012, the Ministry of Economic Development released the Discussion Paper *Auditing and Assurance for Larger Registered Charities* ("the 2012 paper"). The Paper proposed a statutory audit or review engagement requirement for charities that met proposed dollar thresholds. The thresholds as initially proposed were increased, in the February 2013 Paper *Auditing and Assurance for Large & Medium Registered Charities – Concrete Proposals* ("the concrete proposals paper"), as follows:

(a) Registered charities that are "medium-sized" with annual operating expenditure of $400,000 or more for both of the last two financial years would be required to have an audit or review engagement completed; and

(b) Registered charities that are "large" with annual operating expenditure of $1 million or more would be required to have an audit completed.

7. The 2012 paper summarised the "status quo" and the audit issue. Every registered charity is required to submit an annual return to the Charities Commission together with a copy of its financial statements. However, there are currently no accounting standards that apply, and no audit or review requirements.

8. This has resulted in inconsistent accounting approaches. The accounting changes that will come into force on 1 April 2015 should reduce the cost of reporting for the NFP entities to which the simple format standards will apply. At the same time the reliability and comparability of financial reports will be significantly improved.

9. The two assurance options available to medium-sized charities (initially considered in the 2012 paper) are:

   (a) An audit, which requires the auditor to obtain reasonable assurance, based on audit evidence, about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. An audit is a high level of assurance.

   (b) A review, which provides a moderate level of assurance, based on enquiries and the exercise of judgement, that the financial information is not materially misstated. However, there is an unavoidable risk that some material misstatements may remain undiscovered.

10. Large-sized charities will have to be audited – the review option will not be available to them.

11. The concrete proposals paper does not contain a proposed commencement date for the proposed audit measures. The likely commencement date is the date from which the new accounting standards will apply.

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