Wednesday, 7 December 2022

Committee Secretariat
Social Services and Community Committee
Parliament Buildings
Wellington 6140

Dear Committee

Submission on Charities Amendment Bill

As the representatives of over 304,000 professional accountants in Australia, Chartered Accountants Australia and New Zealand (CA ANZ) and CPA Australia welcome the opportunity to provide a submission to the Social Services and Community Committee ("the Committee") on the Charities Amendment Bill ("the Bill"). We would also like to take this opportunity to thank the Committee for extending the submission period by one month to allow charities and sector stakeholders more time to engage with, and participate in, the legislative process.

As leading professional accounting bodies of the country, we are strong supporters of reducing red tape and reporting burden for charities as we acknowledge their contribution to the economy and to the society at large. Many of our members are involved in this sector as advisors, auditors, employees, and volunteers. We also advocate in the public interest for requirements that promote the transparency of this sector and its activities, to stakeholders and the public, in a way that minimises the complexity and cost for the sector.

We acknowledge the rationale behind the proposal to exempt very small charities from financial reporting requirements based on the External Reporting Board (XRB) financial reporting standards. If such an exemption were to be pursued, our preferred approach to operationalise this would be through legislation, rather than by giving financial reporting exemption powers to the Department's Chief Executive, as this would mean all statutory financial reporting requirements are in one place, making it clear to all parties concerned. If this approach is not to be adopted and a decision is made to continue with the proposed approach, any powers given to the Department's Chief Executive should be clearly scoped. Also, any changes undertaken through the exercise of the Department's Chief Executive's powers should be subject to public consultation.

There is a reasonable expectation from the community and funding providers that charities are well governed to fulfil their charitable purpose and are held accountable for all funds provided to them. Smaller charities face distinct challenges; they are often staffed by volunteers with limited financial skills who are tasked with implementing governance and financial controls and preparing financial statements. Increasingly there is also a greater reliance on fewer funders, which presents a financial stability risk. Hence, we believe regulators and legislation should facilitate charities to advance their charitable purpose in a cost-effective manner by reducing complex and costly legislative requirements for smaller charities.

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We have focused our feedback on the proposed amendments to the financial reporting requirements for very small charities. While the needs of the users of the financial information produced by smaller charities and the public interest in their operations must be addressed, the reporting framework for such charities must also consider the balance between the costs of compliance and the benefits of transparency in determining the appropriate reporting framework. We have also included several recommendations on the proposed amendments to the appeals framework.

Our detailed responses are provided in the **Attachment** to this letter. Should you have any questions about the matters raised in this submission or wish to discuss them further, please contact either Zowie Pateman (CA ANZ) at zowie.pateman@charteredaccountantsanz.com or Ram Subramanian (CPA Australia) at ram.subramanian@cpaaustralia.com.au

Sincerely,

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Chartered Accountants Australia and New Zealand

Dr Gary Pflugrath FCPA
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CPA Australia

Attachment

Financial reporting

Clause 19 inserts new sections 42AB and 42AC which enables the chief executive of the Department of Internal Affairs ("the Department's Chief Executive") to exempt a class of qualifying charitable entities from preparing financial statements (in accordance with the financial reporting standards issued by the External Reporting Board (XRB)).

A "qualifying charitable entity" is a charity whose total assets and total operating expenditure are below a threshold which will be prescribed by regulations (the DIA has recommended annual payments under $10,000 and total assets under $30,000 which is about 12% of charities).

A qualifying charitable entity is instead required to report "minimum financial information" to the Department's Chief Executive, the form and content of which will be prescribed by regulations (and may include information about a charity's income, expenditure, assets, liabilities, mortgages, charges, other security interests, related party transactions and donations).

Compliance with financial reporting requirements is critical to enhancing and promoting public trust and to the integrity of the charities sector. Therefore, the evidence gathered that identifies a relatively low and decreasing level of compliance by charities with the financial reporting requirements is a concern. While professional accountants, including our members, have little difficulty in applying the financial reporting standards issued by the XRB in preparing financial statements, the same may not be the case for non-accountants with limited accounting or financial experience, who are often tasked with the preparation of financial statements of smaller charities.

We note that although reducing and/or simplifying financial reporting requirements can lead to improved compliance rates, there is no consensus that this is the best approach. Capability building is essential, and it is critical that those charged with governance of charities, of all types and sizes, possess the appropriate skillset, including financial literacy, to ensure that charities can fulfil their statutory obligations.

We acknowledge the rationale behind the introduction of a power for the Department's Chief Executive to exempt a class of "qualifying charitable entities" from preparing financial statements in accordance with the XRB standards, and instead requiring such entities to report "minimum financial information".

However, we do not support these proposals, as drafted, for the reasons outlined below:

- The XRB has a current active project to revise the Tier 4 financial reporting standard ("the Tier 4 standard"), with the revised Tier 4 standard expected to be issued early next year. We are optimistic that the outcome of this revision will result in further simplification of the Tier 4 standard to enable smaller charities to apply the requirements while preserving the transparency and accountability required for these charities. In our view, if sufficient simplification of the Tier 4 standard is achieved, then there may be no need for the proposed exemption power to be exercised.

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- Under section 43(1)(b) of the Charities Act 2005 the Department's Chief Executive already has the power to exempt an entity from compliance with any provision of subpart 1 of Part 2 – which includes the financial reporting requirements. Given the Bill does not propose any change to this section, it is unclear why this additional power is needed. In addition, in our view, the Department's Chief Executive should be required to conduct a public consultation prior to exercising such an exemption power, given its significance.
- While the term "qualifying charitable entity" is defined (albeit the thresholds will be in regulations), it is not clear what constitutes a "class" of qualifying charitable entities. Use of such a term implies that it is feasible for an exemption to be granted to a subset of charities that are below the given threshold. This approach may not achieve the desired outcome.
- Under section 102 of the Incorporated Societies Act 2022 only smaller incorporated societies without donee status under the Income Tax Act 2007 are exempt from preparing financial statements in accordance with the XRB standards. Charities generally receive donee status from Inland Revenue (IR), unless they operate overseas. Having approved donee status from IR means individuals can claim tax credits for donations over $5 that they make to a charity. Therefore, any financial reporting exemptions given to smaller charities would be inconsistent with the policy decisions made for incorporated societies.
- We envisage similar issues with the reporting of "minimum financial information" to that encountered by incorporated societies in attempting to comply with section 23(1) of the Incorporated Societies Act 1908. Research shows that many incorporated societies struggle to comply with minimum requirements for financial statements of "small societies" (as defined). The lack of specificity around how to recognise, measure, and disclose such financial information is ambiguous, uncertain and complex, especially when considering that many small charities are staffed by volunteers with little financial expertise. Using the Tier 4 standard may not necessarily be more onerous or difficult to apply due to the additional guidance the XRB provides, including a three-page template.

It is reasonable for any financial reporting concessions to be only for the smallest charities. If an exemption is to be given to very small charities, our preference is for the exemption (including criteria and thresholds) to be included within the Charities Act 2005 to minimise uncertainty and complexity for the charitable sector.

By way of comparison, the Australian Charities and Not-for-profits Commission Act 2012 does not require "small" charities (as defined) to prepare financial statements. They are, however, still required to file an Annual Information Statement (AIS) containing specified financial information. This same approach could be taken in New Zealand in terms of requiring an annual return. We are aware that the intention is for the content of the annual return to be aligned with the XRB standards, so this solution would address the policy problem and achieve the policy objectives.

Compliance and enforcement functions

We note there are no amendments proposed to the following offences and resulting penalties for failing to comply with the reporting and audit/review requirements:

- Non-compliance with the requirement to prepare financial statements in accordance with XRB accounting standards: section 42B – the charity and every officer of the charity are liable on conviction to a fine not exceeding $50,000.
- Non-compliance with the requirement to have financial statements audited or reviewed: section 42E – the charity is liable on conviction to a fine not exceeding $50,000.

While the current penalties may be appropriate to address wilful and recurring non-compliance, we believe it is important for there to be a wide range of tools available for use that can be scaled up when necessary. We recommend that administrative penalties be in use for these types of non-compliance in the first instance (the amount of which could be prescribed by regulations). For example, section 58 of the Charities Act 2005 allows for an administrative penalty for not filing an annual return (which must include financial statements) within 6 months of the due date.

Definition of 'officer'

Clause 4 amends section 4 to extend the existing definition of officer to include a person who is able to exercise significant influence over the management or administration of a charitable entity.

We are concerned with this expanded definition because of the potential judgemental interpretation of "significant influence". For example, there is no distinction between governance and management – an employee, such as a chief executive or general manager, could have significant influence. We also note that clause 17 inserts new sections 36A—36D, and section 36C gives the Board the power to disqualify an officer. In the instance of the person being an employee of the charity, this could create potential unintended consequences in terms its interaction with employment law.

Review of governance procedures

Clause 20 inserts new section 42G which creates a duty for a charitable entity to review its governance procedures annually (whether those are set out in its rules or elsewhere).

We do not believe that this amendment was previously subject to public consultation. While we would support an explicit requirement for a charity to regularly review its governance procedures, we believe an annual requirement is too onerous. The frequency of any review should be able to be determined by the charity. Also, if this amendment were to proceed, it is unclear how this would be evidenced and enforced.

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Te Rātā Atawhai, the independent Charities Registration Board

Clause 5 amends section 8 to increase the membership of the Charities Registration Board ("the Board") from three members to five.

We support increasing the number of Board members from three to five to improve the diversity of the Board. However, in our view this does not go far enough to address conflict of interest issues. The current structure involves Charities Services (a business group within the Department of Internal Affairs) preparing the Board meeting agendas and papers, which in our view has the potential to comprise the independence of the Board. We call for greater separation between the policy making, administrative and regulatory functions.

Consultation on significant guidance material

Clause 6 inserts new section 12A which requires the Department's Chief Executive to consult persons or organisations that the chief executive considers to be representative of the interests of charitable entities before issuing significant guidelines or recommendations on the best practice to be observed by charities and persons concerned with the management or administration of charities.

In our view the consultation on proposed best practice material should not be limited to certain persons or organisations. We recommend there be a requirement for a public consultation.

In Australia, the ACNC relies on an adviser forum and a sector forum to provide input to its policy directions and operational matters. The adviser forum includes professional advisers to the charities sector from the accountancy, legal and other professions whilst the sector forum includes participants from the charities sector. A similar approach could be considered as an alternative or in addition to public consultation in some limited circumstances. Whilst we note that Charities Services is supported by the Sector Group, the Charter for this group indicates that the group "is not intended to represent the collective voice of the sector". We suggest consideration be given to embellishing the role of the Sector Group to provide a voice to the charities sector and to the professional advisors who support the sector.

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Appeals framework

Clause 6 inserts new section 12A which requires the Department's Chief Executive to consult persons or organisations that the chief executive considers to be representative of the interests of charitable entities before issuing significant guidelines or recommendations on the best practice to be observed by charities and persons concerned with the management or administration of charities.

We broadly support the purpose of the proposed amendments to expand the appeals framework for charities by empowering the Taxation Review Authority to hear first instance appeals. Providing a greater access to justice, at a lower cost, is in the public interest and would benefit 'smaller' charities.

Proposed new Part 2A will require all appeals to be heard first by the Authority (to be defined in section 4(1) of the Charities Act 2005 as "… an Authority established or deemed to be established under the Taxation Review Authorities Act 1994"). In our view, this approach would undermine the objective sought to be achieved by limiting choices and adding cost and complexity to the appeals process. We recommend the proposal be amended to allow the appellant to choose to lodge an appeal to either the Authority or the High Court in the first instance. Our recommended approach would provide more flexibility and mirrors the rights available to taxpayers for challenging income tax assessments and disputable decisions under sections 138B and 138C of the Tax Administration Act 1994.

Clause 28 of the Bill proposes to amend section 73 of the Charities Act 2005 to insert a power for regulations to be made to provide the procedure for appeals. While this mechanism may be an efficient method to introduce or change the appeals process it will be critical that the details of the regulations promote the objectives of proposed new Part 2A (i.e., the need for proper process should be balanced with the costs imposed). In our view, it would be beneficial to develop the detail of the regulations by undertaking public consultation.

Another aspect of the proposals that should be given more thought is the level of resources that will be available to the Authority to hear appeals. The Bill is silent on this matter. Resourcing will have a significant effect on the success or otherwise of the proposed amendments to the appeals process and should not be overlooked.

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