Coversheet: Reform of the Incorporated Societies Act 1908

Advising agencies	*Ministry of Business, Innovation and Employment*
Decision sought	*Agree to drafting instructions being issued to PCO, so that certain amendments to the draft Incorporated Societies Bill can be made, before its introduction to the House*
Proposing Ministers	*Minister of Commerce and Consumer Affairs, Hon Kris Faafoi*

Summary: Problem and Proposed Approach

Problem Definition **What problem or opportunity does this proposal seek to address? Why is Government intervention required?**
MBIE is proposing amendments to a draft Incorporated Societies Bill before it is introduced to the House. The proposals concern two problems: - The Draft Bill currently requires all incorporated societies to adopt External Reporting Board accounting standards when preparing their financial reports. MBIE considers that this will mean a considerable number of incorporated societies will devote disproportionate resources to attempting to comply with the new standards, and a significant rump simply will not be capable of doing so. This would likely distract societies from fulfilling their objectives and significantly increase enforcement costs for the Companies Office. - For societies that exist on the current register of incorporated societies, the Draft Bill currently provides that they will be migrated automatically to the new register, and that the new rules will apply to them in a staggered fashion over at least 4 years. MBIE considers that automatic migration will compromise the value of the register, that a staggered approach will confuse many societies, and that a transition period of at least 4 years will reduce the cost-effectiveness of an education campaign by the Companies Office.

Proposed Approach **How will Government intervention work to bring about the desired change? How is this the best option?**
Government intervention is the counterfactual – namely the Draft Bill as currently drafted. The factual / proposal is to amend the Draft Bill, in one case to reduce the extent of government intervention, and in the other case to amend the nature of government intervention. More precisely, MBIE proposes to amend the Draft Bill so that: - the requirement that incorporated societies adopt External Reporting Board standards is,

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apart from societies registered as charities (and so subject to the reporting requirements of the Charities Act 2005), limited to societies that have annual payments of $10,000 or more, have assets of $30,000 or more, or have 'donee status' under the Income Tax Act 2007.

- societies that wish to transition to the new register must actively confirm this, and the transition period will become a single period of at least two years.

Section B: Summary Impacts: Benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?

Limiting the requirement to use External Reporting Board standards

Regulated parties: There will be reduced compliance costs for societies that fall below the threshold proposed.
Regulators: There would be a reduced enforcement and education burden on the Companies Office, as it would not have to police, or assist in, the adoption of new standards by the societies least likely to be able to comply with them (though it would continue to police their use of the existing standards).

Change to the transition process

Regulated parties: The risk of confusion amongst societies about which parts of the new statute take effect when, will be eliminated.
Regulators: There would be a reduced enforcement and education burden on the Companies Office, as the risk of de-registration would be an incentive for societies to comply with the new statute, and the reduced transition period would ensure education efforts made by the Companies Office in the early stages are not wasted through officer churn.

Where do the costs fall?

Limiting the requirement to use External Reporting Board standards

Other parties: Members of certain societies, and the general public (eg creditors), will not benefit from the added financial visibility that the use of XRB standards would bring.

Change to the transition process

Regulated parties: Some societies may struggle to make constitution changes within 2 years. Some societies will be put off by extra requirement to file a re-registration form.

What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?

Limiting the requirement to use External Reporting Board standards

The proposed approach means that some incorporated societies will not have to use the new accounting standards in their financial reports. MBIE estimates that around 40% of IS-NRAC (about 25% of all incorporated societies) would benefit from the exemption. That means that their

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members (and the public) will not enjoy the same level of visibility over the financial behaviour of their committee that they might do under the counterfactual. (Members will still have some visibility over the financial activities of the IS-NRAC, as the requirements to report annually and hold AGMs will still apply). In its inter-agency comments, the XRB adds that "a lack of consistency in the basis for preparing financial statements across the sector leads to a reduction of confidence in the sector (and higher risk of misappropriated or inefficient use of members' resources) which weakens the society's ability to pursue its objectives". However, it should be borne in mind that these risks also exist under the counterfactual, since some of the incorporated societies captured under that counterfactual would continue to fail to meet the new standards (due to e.g. lack of accounting expertise) and others may decide to dis-incorporate (in order to avoid having to apply the new standards).

Change to the transition process

With the move to a requirement for active re-registration, MBIE anticipates that a number of societies will not try to re-register because they decide that incorporation is no longer worth the administrative burden (i.e. the hassle of filling in a re-registration form). Those societies – a number of which may be making valuable contributions to New Zealand society – will have to try to carry on as unincorporated societies (legally less simple for them), or disband entirely. This would reduce the contribution that not-for-profit entities make to New Zealand society. There is also some level of risk for officers of a society that might be unaware that the society has been de-registered, and continue to enter into transactions in the belief that they still enjoy limited liability. However, our understanding of case law under the Companies Act 1993 is that, upon restoration to the new register, any personal liability so incurred would be superseded by the restored society's liability.

In respect of the move to a single transition period of at least two years, this would make it more difficult for a number of incorporated societies to adapt to the new statute, ahead of the new statute coming into force. Societies most likely to be affected are those that are very small (and so lack the resources to undertake the changes quickly) and those that are very large (for whom organising the necessary general meetings is a logistical challenge). Many such societies may end up transitioning to the new regime with a non-compliant constitution. This will in turn risk creating an additional enforcement burden on the Companies Office, as it attempts to root out the non-compliance over time.

Identify any significant incompatibility with the Government's 'Expectations for the design of regulatory systems'.

N/A

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?

In Section 5 of this RIA, MBIE scores our 'evidence certainty' as medium. On the one hand, the conclusions in this RIA are based on a comprehensive consultation process that has included a Law Commission report, an exposure draft of the Incorporated Societies Bill, targeted consultation of Maori, trade unions and selected legal experts, and robust inter-agency discussion. On the other hand, it has been difficult to access evidence in quantitative form, notably because the current register of incorporated societies does not have functions allowing the extraction of aggregated data.

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To be completed by quality assurers:

Quality Assurance Reviewing Agency:
Quality Assurance Assessment:
Reviewer Comments and Recommendations:

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Impact Statement: Reform of the Incorporated Societies Act 1908

Section 1: General information

Purpose
The *Ministry of Business, Innovation and Employment* is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by or on behalf of Cabinet.
Key Limitations or Constraints on Analysis
The delineation and quantification of the problem, as well as the assessment of the options to address it, has faced the problem of a lack of objective evidence. This is the case for a number of reasons. First, there is an absence of aggregate information available from the Register of Incorporated Societies. The Register as it stands does not provide any aggregate information about societies' objectives, activities, finances, or size. We have addressed this by relying on random sampling from the Register and by using the more advanced Charities Register to generate, as a proxy guide, aggregate information on registered charities (noting that one third of incorporated societies are registered charities). Second, it is not easy to quantify the extent to which an option studied will address the policy problems identified. For this reason, much of the analysis of options is based on qualitative assessment.
Responsible Manager (signature and date):
Susan Hall Business Law Commerce, Consumers and Communications Ministry of Business, Innovation and Employment

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Section 2: Problem definition and objectives

General introduction

A 'society' can be described as a group of people who associate for a particular purpose, and are organised according to certain rules. It might be a sports club, a ratepayers association, or a marae. An 'incorporated society' is a group of such people who have registered under the Incorporated Societies 1908 Act (the 1908 Act). There are over 23,000 such entities currently appearing on the Incorporated Societies Register (the Register), from NZ Rugby – which in FY 2016 had an income of $162 million – to the Banks Peninsula War Memorial Society – which in FY 2016 had an income of $5,889. Together, incorporated societies make a significant contribution to New Zealanders' well-being.[1]

A Law Commission report of 2013 entitled *A New Act for Incorporated Societies* identified numerous problems with the 1908 Act. In February 2014, following an MBIE-prepared RIS dated 5 February 2014, the Government responded to the Law Commission report, agreeing to 101 of the Law Commission's 102 recommendations in full or in principle [EGI Min (14) 2/3 dated 19 February 2014 refers].

In November 2015, MBIE released a draft bill for public consultation (the Draft Bill) that will replace the Incorporated Societies Act 1908. MBIE received 116 submissions on the Draft Bill, which demonstrated a high level of support for the reforms.

In March 2018, the current Minister of Commerce and Consumer Affairs directed officials to continue with the work begun under the previous Government. More recently, targeted consultation with Māori, the Companies Office, and other groups has been undertaken. This work has led MBIE to conclude that certain changes will need to be made to the Draft Bill prior to its introduction.

If the changes are not made, we consider that the Draft Bill will not be fit-for-purpose upon its introduction to the House. This will lead to additional work for the Parliamentary select committee to which the Bill is referred. It will also frustrate the purpose of MBIE's public consultation process, damaging relations between the Ministry and its stakeholders.

A Accounting standards for financial reports

A.1 What is the context within which action is proposed?
Incorporated societies that have registered as charities under the Charities Act 2005 (about one third of all incorporated societies) send their annual financial reports to the charities sector regulator, Charities Services, and in preparing those reports must (since 2015) use accounting standards set by the External Reporting Board. By contrast, incorporated societies not registered as charities (IS-NRAC) send their financial reports to the Registrar of Incorporated Societies, and follow only basic legislative requirements in their accounting (section 23 of the 1908 Act). The Draft Bill would, as drafted, require all IS-NRAC to adopt the same External Reporting Board accounting standards as registered charities.[2] This is the counterfactual.

[1] Statistics New Zealand has estimated that not-for-profit entities made a contribution to NZ GDP in 2013 of $9.4 billion (representing 4.4% of total GDP). Incorporated societies account for perhaps 1 in 5 of these entities. Source: Stats NZ, The contribution of non-profit institutions in New Zealand, June 2016.

[2] IS-NRAC would however continue to file their financial reports with the Registrar of Incorporated Societies

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A.2 What regulatory system, or systems, are already in place?

The 1908 Act is part of the corporate governance regulatory framework, of which the Ministry of Business, Innovation and Employment has regulatory stewardship. It must be read alongside the Incorporated Societies Act 1920 and has been supplemented by the Incorporated Societies Regulations 1979 and case law.

A.3 What is the policy problem or opportunity?

Nature of the problem

Based on MBIE's knowledge of the skill-sets and resources available to many incorporated IS-NRAC, and on what we understand Charities Services has seen in overseeing the switch by registered charities to External Reporting Board standards, we consider that – if the Draft Bill is left as it is – there will be a considerable number of incorporated societies that devote disproportionate resources to attempting to comply with the new requirements, and a significant rump who simply cannot.[3] This is *despite a planned multi-year education campaign* to be run by MBIE's corporate governance policy team and the Companies Office.

Such an outcome will: first, detract from IS-NRACs' ability to perform their prime function; and second, place increased demand on the Companies Office in terms of detecting and enforcing compliance with the new Act.

Size of the problem

Introduction

Charities Services ran an education campaign to accompany the introduction of External Reporting Board accounting standards. During this campaign, it became clear to the regulator that many attendees struggled with basic accounting concepts. This has been reflected in the compliance by registered charities with the new rules. In a July 2017 internal report, Charities Services noted that, in the first year after the new standards were introduced, only 38% of (randomly selected) "Tier 4" charities (those whose annual expenditure was less than $125,000) correctly used the new accounting standards. In the second year of checking a sample of reports, this "success" rate has still only increased to 59% for charities reporting using the Tier 4 standards. Anecdotal evidence suggests that charities have had to spend more time preparing their financial reports.

Societies' function

At least in the short term, the more time and resources societies spend preparing financial reports, the less time they spend pursuing their objectives. These objectives cover a vast range, from maintaining monuments, to organising sports, to promoting health amongst deprived communities. If IS-NRAC have less time or money to pursue these objectives, their contribution to GDP, as well as to less quantifiable measures such as general well-being, will be reduced. It will fall to the Government to either provide the foregone contribution or live with its loss.

It is important, however, not to exaggerate this risk. In particular, the switch to new accounting standards could in the longer term actually benefit the functioning of many societies – at least those that prove capable of using those standards. As the XRB comments, "the proposed new reporting requirements in the draft bill will ultimately support the wellbeing of a society's members and the wider New Zealand community – by promoting the preparation of standardised financial reports

3 The outcome may be even worse than it was for registered charities, since IS-NRAC will not have the compliance incentive of tax-free status that registered charities do.

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which ensure committees are sufficiently accountable to members for the effective and efficient stewardship of the resources controlled on behalf of members".

Increased enforcement costs

Even under the current regime, the Companies Office does not have the resources to verify that all financial reports sent in annually by IS-NRAC comply with the applicable requirements (particularly where they are uploaded online rather than sent by post). Instead, enforcement is effected through random-sampling audits and also by responding to members of the public and members of IS-NRAC who contact the Companies Office when they see deficiencies in documents.

We anticipate that the number of non-compliant financial statements found during audits, or brought to the Companies Office's attention, would increase significantly if all IS-NRAC were expected to use the new External Reporting Board standards. While this would likely decrease over time, a not insignificant rump of IS-NRAC (likely many hundreds) would almost certainly remain non-compliant for many years, if not indefinitely. This would require the Companies Office to trigger enforcement action (escalating from notices to fines to eventual removal from the register) much more often than currently. This would in turn require the hiring of additional staff. In turn, if the society is removed from the register there may be implications for dealing with society assets etc and cost associated with restoring the society to the register – CO costs in resource and society costs – application fee, legal fees etc.

Other risks

It is possible that, in the face of a requirement to adopt the External Reporting Board accounting standards, some IS-NRAC will decide to de-register and continue as unincorporated societies or wind up entirely. While this would potentially reduce the number of societies that struggle to comply with new accounting rules, it would do so at a cost: the contribution that those societies make to New Zealand would be affected (as they would lose the benefits of incorporation) or even ended (if they wind up); and its members and the general public would lose financial visibility over them (as they would no longer need to file annual financial statements).

It is also possible that some IS-NRAC will decide that, if they have to have to use the same accounting standards are registered charities, then they may as well attempt to register as charities. Those that are successful would no longer pay tax on their income, and so government revenue would be reduced. However, this risk should be seen in context: all IS-NRAC already benefit from an income tax exemption on their first $1,000 of income; there is also an exemption for any society, trust or association set up for the purpose of promoting any amateur sport, such as a cricket club, which are exempt from income tax, unless their funds are used for the private benefit of the club's owners, shareholders, members, beneficiaries or associates.

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A.4 Are there any constraints on the scope for decision making?

Decisions have only been considered on what amendments to the Draft Bill might be appropriate. This RIS does not reconsider the need for the reform of the Incorporated Societies Act 1908, a matter already addressed in the MBIE-prepared RIS dated 5 February 2014.

A.5 What do stakeholders think?

Who are the relevant stakeholders?

The concerns discussed above regarding the implementation of accounting standards issued by the XRB for all IS-NRAC affects:

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- IS-NRAC, as they will (under the counterfactual) be required to invest additional resources to implement the necessary changes to meet the reporting requirements in standards issued by the External Reporting Board;
- the Registrar of Incorporated Societies and the team at the Companies Office, as they will be required to provide an appropriate level of monitoring and education activities to support the implementation of accounting standards issued by the XRB for IS-NRAC.

Other interested parties include the External Reporting Board (XRB), as they are responsible for developing accounting standards, and Charities Services, as they have had experience supporting small entities (including incorporated societies registered as charities) in addressing challenges in applying the accounting standards issued by the XRB.

What consultation on the problem has taken place?

Law Commission 2013

The Law Commission published an Issues Paper for public consultation in 2011. Its conclusion in its report of 2013 suggested that financial reports prepared using the XRB standards (which had not then been finalised) would not "necessarily be more onerous or difficult to complete" than reports prepared under the present regime,[4] but at the same time acknowledged that "despite the relative simplicity of the [current] reporting requirements, many societies struggle to comply".[5]

MBIE 2015-2016

MBIE published the Draft Bill in 2015 and by 2016 received 116 responses. Submitters were split in their views about whether very small societies should have an exemption, with a number of IS-NRAC in favour and a number of accountancy and auditing firms against. MBIE's conclusion at the time was that "at this stage we are tending towards the view that there should be a micro-entity exemption. This is mainly due to feedback we have received from DIA Charities Services, about how well registered charities have adjusted to becoming reporting entities in the last year or so."[6]

MBIE 2018

MBIE undertook targeted consultation in 2018 to supplement the responses to the 2015-2016 consultation. This included speaking to IS-NRAC, the Companies Office, Charities Services, the ERB, and some accountancy firms. Some funders (who occasionally donate to societies) were approached but declined to engage.

Who shares MBIE's view of the problem?

A number of IS-NRAC who submitted on the MBIE exposure draft consultation, the Companies Office, and Charities Services all share MBIE's view of the problem, namely that there will be significant and enduring non-compliance with the new accounting standards if the counterfactual proceeds.

Who does not share MBIE's view of the problem?

The XRB does not believe that the requirement for all IS-NRAC to adopt XRB standards creates a problem requiring any change to the Draft Bill. It notes that all incorporated societies currently have a statutory requirement (under the 1908 Act) to prepare annual financial reports and file them with the Companies Office and considers that, once a small IS-NRAC accepts that they need to do

[4] Ibid., para 6.153

[5] Law Commission report, para 6.147

[6] MBIE Briefing 3760 17-18

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something different, there will be some investment of additional resources in the first year of adoption, but after this period the resources required will progressively decrease to a point where application of the new reporting requirements is business as usual.

The XRB support their view with the following points:

- They question whether the XRB accounting standards that will apply to smaller societies (so-called Tier 4 accounting standards) are actually materially more difficult to apply than the current requirements under section 23 of the 1908 Act.[7] They acknowledge that "there are a number of differences between current minimum requirements in legislation and Tier 4 requirements" but that "whether the additional … Tier 4 Requirements are considered overly onerous will depend on the preparer's experience preparing financial statements in accordance with GAAP [generally accepted accounting principles] and the complexity of the society's activities".[8]
- They consider that, based on the experience of Charities Services, compliance with the new accounting standards may be difficult at first but will improve quickly over time. While they concede that a small number of societies may continue to struggle with the new standards, they believe that the compliance challenges experienced by Tier 4 registered charities has not been one of significant difficulties in applying the new reporting requirements, but more about getting the message across that these smaller entities have new requirements and cannot continue to prepare annual financial reports in the same manner as previous year's.
- They argue that, consistent with any regulatory requirements, there always be level of non-compliance (organisation/people that simply refuse to comply with the law), but this percentage of non-compliance will ultimately be reduced to an acceptable level in time.

Some accountancy and auditing firms have suggested that technology developments, such as cloud-based accounting services, will enable even small IS-NRAC to comply with the new accounting services. As a result, they consider that the problem identified by MBIE will resolve itself over time.

MBIE acknowledges that technology may assist some smaller societies to adapt to the new accounting standards. However, not all societies will be able to afford such services, and not all societies will have members able to use such services.

Māori

We do not believe that Māori are affected differently from others by the concerns discussed above regarding the implementation of accounting standards issued by the XRB by smaller IS-NRAC. There are no statistics available on the financial resources of Māori-based IS-NRAC.

More broadly, however, there are perhaps some inherent difficulties in interpreting the standards in a Māori context. The primary example of this would be determination of who is and is not a related party for the purposes of financial reporting. Of course, this is a challenge of the standards in general and would not be restricted to just IS-NRACs.

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[7] Section 23 of the Incorporated Societies Act 1908 requires IS-NRAC to "deliver annually to the Registrar, in such form and at such time as he or she requires, a statement containing the following particulars: (a) the income and expenditure of the society during the society's last financial year; (b) the assets and liabilities at the close of the said year; and (c) all mortgages charges, and securities of any description affecting any of the property of the society at the close of the said year".

8 Email dated 7 June 2018 from the External Reporting Board's Director Accounting Standards (Anthony Heffernan) to MBIE (Senior Policy Advisor, Robert Clarke)

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B Transitional arrangements for existing societies

B.1 What is the context within which action is proposed?

The Draft Bill contains a transition regime for societies already registered on the incorporated societies register at the time that the new statute comes into effect.

More specifically, it provides for a staggered application of the new regime to existing societies, over a minimum of four years. After a first grace period (of at least two years), provisions relating to certain matters (e.g. dispute resolution procedures) would take effect. After a second grace period (of at least another two years), provisions relating to all other matters (e.g. new officer eligibility rules) would take effect.

B.2 What regulatory system, or systems, are already in place?

The Incorporated Societies Act 1908 is part of the corporate governance regulatory framework, of which the Ministry of Business, Innovation and Employment has regulatory stewardship. It must be read alongside the Incorporated Societies Act 1920 and has been supplemented by the Incorporated Societies Regulations 1979 and case law.

B.3 What is the policy problem or opportunity?

Nature of the problem

The transition process is not ideal because:

- its staggered nature risks confusing some incorporated societies about what obligations apply when;
- its duration is too long, as high officer churn would mean efforts by the Companies Office in years 1 and 2 to educate officers about the changes would likely need to be repeated in years 3 and 4; and
- its automatic application to all existing societies, whether they make the necessary changes or not, would lead to substantial numbers of societies on the new register having non-compliant constitutions and ineligible officers. This would create a significant burden on the Companies Office team charged with enforcing compliance.

Size of the problem

Confusion among incorporated societies

As not-for-profit entities, incorporated societies rely to a greater or lesser degree on members volunteering their time and energy. Funding can be scarce, and use of such funds for legal or other professional advice is not as strong a reflex as it might be in a for-profit entity such as a company. In this context, MBIE anticipates that **a significant minority** of societies will struggle to understand what obligations they must comply with after the first grace period comes into effect, and which they need not.

Repetition of education efforts

Each grace period in the current transition regime is at least 2 years long. This means that there will be at least 4 years between the new statute coming into effect and its provisions all coming into force. Furthermore, in order to ensure that societies are actually aware they will enjoy grace periods, education efforts will need to begin even before the new statute is adopted, and in order to help societies comply with their obligations, education efforts will need to continue after all the statute's

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provisions come into force.

Many of the provisions of the new statute will affect the members of a society's committee. The experience of the Companies Office is that, **in a majority of societies**, members seldom remain on a committee for longer than 3 years. This churn means that much of the education efforts in the first grace period could have to be repeated in the second grace period.

Compliance enforcement burden

In MBIE's view, knowing that they were guaranteed automatic registration on the new register, **a significant minority of societies** would fail to make the changes to their constitutions required by the new statute. It would then fall to the Companies Office to detect these non-compliant constitutions, to engage with the societies concerned to encourage them to make the necessary changes, and where appropriate to remove recalcitrant societies from the register. This would generate a significant drain on the resources of the Companies Office.

B.4 Are there any constraints on the scope for decision making?

Decisions have only been considered on what amendments to the Draft Bill might be appropriate. This RIS does not reconsider the need for the reform of the Incorporated Societies Act 1908, a matter already addressed in the MBIE-prepared RIS dated 5 February 2014.

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B.5 What do stakeholders think?

Who are the relevant stakeholders?

The transition problem identified affects:

- incorporated societies already registered on the incorporated societies register at the time that the new statute comes into effect;
- the Registrar of Incorporated Societies and his team at the Companies Office, as they will have to police the transition.

What consultation on the problem has taken place?

Law Commission 2013

The Law Commission published an Issues Paper for public consultation in 2011. Its conclusion in its report of 2013 suggested that "the transitional period should not be too short. An affected society will need to consult thoroughly with all its members, probably at more than one general meeting." While recognising that "it is hard to determine how long" the transitional period should be, it recommended "not less than four years."[9] It did not discuss the idea of staggering the entry into force of different obligations. It assumed without exposition that all existing societies would automatically transition to the new regime.

MBIE 2015-2016

MBIE published the Draft Bill in 2015 and by 2016 received 116 responses.

[9] Law Commission report, at paras 7.62 and 11.68

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MBIE 2018

MBIE undertook targeted consultation in 2018 to supplement the responses to the 2015-2016 consultation. This included speaking to the Companies Office and legal experts.

Who shares MBIE's view of the problem?

The Companies Office agrees with MBIE that the current transition arrangements will lead to the problems identified. Legal experts spoken to during the 2018 targeted consultation conceded that such problems would likely develop under the status quo.

Who does not share MBIE's view of the problem?

For the MBIE consultation of 2015-2016, a majority of submitters who touched on the transition issue were broadly in favour of the Draft Bill's generous timeframe for transition. The staggering of the transition did not, however, attract specific comment, nor did the automatic re-registration of existing societies.

Māori

We do not believe that Māori are affected differently from others by the transition problem. MBIE raised the issue of the current transition requirements with Māori during the targeted consultation period, and they largely agreed that those requirements could generate the problems identified.

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Section 3: Options identification

A Accounting standards for financial reports

A.1 What options are available to address the problem?

Introduction

MBIE has considered three main options. They are described (widest, narrowest) in terms of what proportion of IS-NRAC will be required to use the new accounting standards:

i. Widest, "non-regulatory"[10] option: Draft Bill remains unchanged, meaning all IS-NRAC must move to new standards, but extra funding is made available for the planned education campaign;

ii. Narrowest, single-threshold option: Draft Bill is amended so that only IS-NRAC with annual payments at or above a certain threshold must move to new standards.

iii. Middle-way, multi-threshold option: Draft Bill is amended so that IS-NRAC with annual payments at or above a certain threshold, *or* with assets at or above a certain threshold, *or* which have 'donee' status under the Income Tax Act,[11] must move to new standards;

These options are mutually exclusive.

Option (i): widest option – status quo with extra funding

Key features

Officials are already planning to seek funding to ensure a smooth roll-out of the replacement Act. We will be seeking the following capital and operational funding allocations for the Registrar (making a total of $4.072 million):

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Capital Funding total	$1,100,000						
Operational Funding total	$254,000	$594,000	$628,000	$374,000	$374,000	$374,000	$374,000

Capital funding will be used to deliver the system enhancements to the Business Registers Platform required to meet new register functions introduced by the new Act, support dual system functions for both Acts during the transition period, and a cease old Act functions at the end of transition. It will include technical resources to manage the design and implementation of system changes and system and vendor costs to deliver the enhancements at the various phases of the commencement and transition.

Operational funding will be used for extensive stakeholder engagement activity and support leading up to the commencement of the Act and throughout the transition period. The predicted peak in Year 2 is based on the two-year transition period expiring at the end of that year. Funds will also be used to meet ongoing system maintenance and central support costs.

As noted in Section 2-A.3, the counterfactual already takes account of this work (see reference in that section to "*a planned multi-year education campaign*"). In other words, the problem as described will not be alleviated by the funding already sought.

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[10] This option is 'non-regulatory', in the sense that it does not seek to amend the Draft Bill. However, in a sense it is the most regulatory option, since it would mean there was no exemption for IS-NRAC to the Draft Bill's financial reporting rules.

[11] If an incorporated society (or other entity) is a donee organisation, then taxpayers can receive tax benefits for monetary donations they make to the society. The advantage societies gain from this status makes transparency around their financial statements more important.

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Under Option (i), then, the Government would grant additional funding on top of the funding described above. The additional funding could be targeted at IS-NRAC that struggle to adapt.

Impact on problem

The counterfactual, under which compliance issues are expected to continue, includes planning for the spending of $4.072 million, including operational spending of $2.972million over 6 years. The funding planned is already sufficient for us to communicate with most societies about the accounting changes, but problems with compliance will relate to members' innate capacity to understand and implement those communications. That capacity is difficult to shift and, in this context, we anticipate that additional funding will have only a marginal impact on the management of compliance issues.

Consultation

MBIE has not specifically consulted on the idea of increasing the funding available for the education campaign, as the details of that campaign are not yet settled. However, it is safe to assume that, of the three alternatives to the status quo considered, Option (i) would be the preferred option of the External Reporting Board, most accountancy and auditing firms, and at least one IS-NRAC (the Federated Mountain Clubs of New Zealand, considered that, while there might be problems for smaller societies, they should be expected to adapt. "Federated Mountain Clubs recommends that, after the new Act is passed, the Registrar investigate the option of providing for incorporated societies which are Tier 4 … a template on the Registrar's website to make it easier for small clubs to complete a return".)

Option (ii): narrowest option – single threshold

Key features

Under this option, only IS-NRAC that have annual payments at or above a certain threshold would be required to adopt the new accounting standards. IS-NRAC that do not meet the threshold could continue to follow the basic financial reporting rules (which contain no accounting standards) currently set out in section 23 of the 1908 Act.

Annual payments have been chosen over annual income because they tend to be less "lumpy" than income (which can be affected by one-off donations). Charities Services also believes that annual payments would represent a more accurate measure of the true size of an IS-NRAS by representing their usual activities. Annual payments (or, when accrual accounting is used, annual expenditure) is also the threshold adopted by the External Reporting Board for the different "tiers" of standards that they develop (e.g. Tier 4 accounting standards apply to public-benefit entities with annual payments under $125,000).[12]

For the annual payments threshold, we have considered $10,000, $50,000, and $125,000 (the last threshold level corresponding to the threshold for Tier 4 entities under the External Reporting Board rules). To adjust the thresholds for inflation over time, a similar mechanism as that set out in section 48 of the Financial Reporting Act 2013 (Minister reviews at least every 8 years) could be envisaged.

Impact on problem

The impact on the problem would depend on the level at which the threshold is set:

- At $10,000, MBIE estimates that around 40% of IS-NRAC (about 25% of all incorporated societies) would benefit from the exemption (based on a random sample of 42 IS-NRAC in which 18 had payments of less than $10,000). This would partially eliminate the problem of

[12] The amount of $125,000 was not set by the XRB; rather it was established by section 46 of the Financial Reporting Act 2013.

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non-compliance – we anticipate some societies with annual payments above $10,000 will still struggle to comply with the new accounting standards.

- At $50,000, MBIE estimates that up to 80% of IS-NRAC (about 50% of all incorporated societies) would benefit from the exemption. This would largely eliminate the problem of non-compliance. Few societies with annual payments above $50,000 would struggle to comply with the new accounting standards, at least after the initial few years.
- At $125,000, MBIE estimates that up to 90% of IS-NRAC (about 60% of all incorporated societies) would benefit from the exemption. This would almost entirely eliminate the problem of non-compliance.

Risks

A threshold means that some incorporated societies will not have to use the new accounting standards in their financial reports. That means that their members (and the public) will not enjoy the *same* level of visibility over the financial behaviour of their committee that they might do under the counterfactual. (Members will still have some visibility over the financial activities of the IS-NRAC, as the requirements to report annually and hold AGMs will still apply). In its inter-agency comments, the XRB adds that "a lack of consistency in the basis for preparing financial statements across the sector leads to a reduction of confidence in the sector (and higher risk of misappropriated or inefficient use of members' resources) which weakens the society's ability to pursue its objectives". However, it should be borne in mind that these risks also exist under the counterfactual, since some of the incorporated societies captured under that counterfactual would continue to fail to meet the new standards (due to e.g. lack of accounting expertise) and others may decide to dis-incorporate (in order to avoid having to apply the new standards).

The size of these risks varies according to which of the three variations of Option (ii) is adopted:

- At $10,000, the lack of visibility would be limited, affecting around 40% of IS-NRAC
- At $50,000, the lack of visibility would be widespread, affecting up to 80% of IS-NRAC.
- At $125,000, the lack of visibility would be near total, affecting up to 90% of IS-NRAC.

Thresholds at $50,000 and $125,000 would also significantly 'over-reach', meaning that, if those thresholds were used, a large number of IS-NRAC that would have the resources to comply with the new accounting standards, would not be required to.

Based on this analysis of risks, and bearing in mind the impact of each threshold level on the problem, MBIE concludes that a threshold set at $10,000 would have the best cost-benefit profile.

An additional issue is that the current position of the External Reporting Board is that all not-for-profit entities with a statutory requirement to prepare financial statements in accordance with standards issued by the External Reporting Board (at present mainly registered charities), should have the same reporting requirements, applying the same tier structure (with no exemptions). Under this approach, once a decision is made to introduce External Reporting Board reporting requirements for IS-NRAC, then IS-NRAC should have the same reporting requirements as other not-for-profits.

In this context, MBIE accepts that there needs to be a good justification for why certain IS-NRAC can be allowed to have lower levels of accountability than equivalent registered charities. For MBIE, that justification is that IS-NRAC do not benefit in the same way from tax exemptions. It is true that all not-for profits (including IS-NRAC) receive tax concessions to some degree: they all have a $1,000 income tax deduction; they all have access to GST concessions (if they have a taxable activity); and they have the potential to have access to donee status which also brings possible exemption from the fringe benefit tax rules. However, unlike registered charities, IS-NRAC do not receive complete exemption from income tax. In this contest, IS-NRAC have primary accountability to their members rather than the broader public in the way they registered charities do.

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Consultation

Some respondents to the public consultation (mostly accountants and auditors) are in favour of all incorporated societies being reporting entities – Option (i). Other respondents proposed an exemption for smaller societies from using the new accounting standards – Option (ii). For example, Hui E! Community Aotearoa (a pan-society organisation) stated that the new standards would be "an unnecessary compliance burden for very small societies... Realistically, groups will avoid reporting to government not because they have anything to hide, but because of lack of skills and confidence at filling government forms". However, these respondents disagreed amongst themselves over the level that the threshold should be set. Most respondents proposed annual payments thresholds ranging from $10,000 to $30,000.

Option (iii): middle-way option – multi-thresholds

Key features

Under this option, an IS-NRAC will be required to adopt the new accounting standards not only if it meets an annual payments threshold, but also if it meets an asset threshold, or if it has 'donee' status under the Income Tax Act 2007. As such, under this option, more IS-NRAC would be required to use the new accounting standards than under Option (ii). To put it another way, fewer IS-NRAC would be exempt.

An asset threshold has been chosen to address situations where a relatively wealthy IS-NRAC (such wealth making compliance with new standards a realistic goal) goes through periods of low payments.

A 'donee' status threshold has been chosen to address the public interest that such status creates. If an IS-NRAC is a donee organisation under the Income Tax Act 2007, taxpayers can receive tax benefits for monetary donations they make to the IS-NRAC.

Level of the thresholds

This option assumes, based on the analysis of Option (ii) above, that the level of the annual payments threshold should be set at $10,000.

For the asset threshold, we have considered $30,000 and $50,000.

One potential issue is that many IS-NRAC that have significant assets but low payments may have illiquid assets such as buildings. In these cases while they may appear resource rich, there is no way for them to easily part with their assets. Subject to further inter-agency consultation, MBIE may recommend that the assets threshold apply to 'current assets' only (assets easily convertible to cash'), although this may then raise interpretation problems

Impact on problem

Option (iii) would have a similar impact on the problem as Option (ii). Although it would lead to more IS-NRAC being required to use the new accounting standards than under Option (ii), its focus on the resources /assets of IS-NRAC means that the additional societies captured will mostly be ones capable of affording professional assistance to adapt.

It is not possible to precisely quantify how many additional IS-NRAC would be required to use the new accounting standards under Option (iii) – compared to Option (ii) – because of their assets or donee status. This is due to the basic nature of the current register, which does not allow the extraction of aggregated data about societies. However, we might broadly expect the number to be in the hundreds:

- A random survey by MBIE of 42 IS-NRAC found that, of the 18 that had payments of less than $10,000, one had assets in excess of $30,000 (Hurunui District Landcare Group Inc.) while none had assets in excess of $50,000. Applied to all 16,000 IS-NRAC, that result would equate

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to around 380 IS-NRAC having payments of less than $10,000 but assets in excess of $30,000, or no IS-NRAC having payments of less than $10,000 but assets in excess of $50,000. In this context, MBIE proposes to set the asset threshold at $30,000 – otherwise it risks capturing no IS-NRAC at all.

- IRD data shows about 750 entities with donee status have "inc" or "incorporated society" in their name, and/or are coded IS (incorporated society) in the IRD system.[13] Some of these will already be captured under the other two thresholds.

Risks

The risk associated with Option (iii) is the same as that associated with Option (ii), namely a threshold will mean that cases of financial mismanagement may go undetected. However, because some IS-NRAC that would have escaped the requirement to use the new accounting standards under Option (ii), will be caught under Option (iii), that risk is reduced somewhat.

Consultation

This option emerged from targeted consultation with IRD. IRD's main interest was to ensure that incorporated societies that have donee status are not carved out of the reporting standards irrespective of their size. However, IRD also suggested an asset test for defining "small" entities. In this regard, IRD's view has always been that thresholds should be based on both the profit and balance sheet indicators, and have successfully argued that for-profits have both thresholds for reporting requirements.

The option was further tested during the targeted consultation of 2018 with legal experts, Māori, trade unions, and others. No major concerns were raised.

A.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The impact of each option on the problem has been assessed by reference to:

- the number of IS-NRAC that will be required to use the new accounting standards: the more IS-NRAC that must use the standards, the larger the problem will be for the Registrar to manage non-compliance;
- the risk of financial mismanagement in IS-NRAC going undetected: the more IS-NRAC that must use the standards, the lower the risk of such lack of detection;
- the short-term funding costs to government.
-

A.3 What other options have been ruled out of scope, or not considered, and why?

Abandoning the new accounting requirements for all IS-NRAC

The option of dropping the requirement for new accounting standards altogether has not been considered. Under such an option, all IS-NRAC would continue to file financial statements in accordance with the current basic financial reporting rules (which contain no accounting standards) currently set out in section 23 of the 1908 Act.

This option was not considered because MBIE accepts the general proposition that IS-NRAC should

[13] A further thousand or so are entities recorded S (society) and IRD would not know whether they are incorporated societies without manually searching them on the companies register. IRD suspect many of them are, but do not know exactly how many.

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use External Reporting Board standards. MBIE's concern has only ever been that smaller IS-NRAC would struggle to do so for practical reasons.

Having the exemption available to 'member-funded' societies

The jurisdiction of British Columbia reformed its version of the Incorporated Societies Act in 2016.[14]

Under the reformed statute, exemptions from certain obligations exist for societies that do not solicit or receive public donations i.e. that are strictly funded from membership fees (on the basis that there is therefore little or no public interest in transparency about their activities).

It would be possible to adopt such an approach when considering an 'exemption threshold' from the requirement, under the Draft Bill, to use the External Reporting Board accounting standards.

MBIE discussed this idea with a number of stakeholders during the 2018 targeted consultation. It was dismissed because: (i) it was broadly considered much more difficult to implement than the options considered above; and (ii) it was also thought to have the potential to result in unfair outcomes e.g. sports clubs would have to turn down gifts of dart boards, old soccer balls, etc.

Switching responsibility for incorporated societies to Charities Services

It would be possible to give Charities Services the responsibility of being the regulator of incorporated societies. Given the many learnings gained from assisting registered charities across all tiers to apply the accounting standards issued by the XRB, this would likely mean that Charities Services could minimise the difficulty IS-RAC have in adapting to the new standards. MBIE has not considered this option in detail, as we consider that the incorporated societies regime and the charities regime are fundamentally different – the former is designed to give entities legal personality and govern their administration and winding up, while the latter is designed entities to provide tax breaks.

B Transitional arrangements for existing societies

B.1 What options are available to address the problem?

Introduction

The status quo is a staggered, (minimum) four-year transition period, with automatic re-registration. MBIE has considered three main alternatives:

i. switching to a single transition period;
ii. switching to a shorter transition period;
iii. switching to a single, shorter transition period.

Upon choosing one of these alternatives, MBIE has then considered options to manage the problems caused by automatic re-registration:

a. extra funding is made available for enforcement by the Registrar;
b. active re-registration by societies is required.

Option (i) - single transition period

Key features

[14] See the following website for details: https://www2.gov.bc.ca/gov/content/employment-business/business/not-for-profit-organizations/societies-act-transition

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Under this option, the staggered approach to the transition is abandoned. After a single period of grace of (at least) four years, a society registered under the new statute must comply with all the statute's obligations, whether they concern dispute resolution matters (currently planned to enter into force after two years), new officer eligibility rules (currently planned to enter into force after four years), or any other obligation.

Impact on problem

Option (i) would effectively address the problem of confusion amongst incorporated societies. There would no longer be any need for the society to work out (or pay a professional to work out) what obligations have to be complied with and in what order.

The option would have no impact on the problem of churn (requiring repeated education efforts), as the period of transition would remain (at least) 4 years. It would also not reduce the cost to the Companies Office of managing two registers for at least four years (with two sets of data requirements, two sets of filings, two compliance routines…).

Risks

Under Option (i), certain obligations that are currently set to enter into force earlier than others (notably the requirement to set out dispute resolution rules in the constitution, and the requirement to ensure surplus assets are only distributed to not-for-profit entities) would in fact enter into force at the same time as the majority of obligations (such as the requirement to set out in the constitution how general meetings will be organised, and the new requirements regarding officer eligibility).

This would mean that, under Option (i), there would be a longer period of time (than under the Draft Bill as currently drafted) during which the constitutions of many societies remain without fit-for-purpose provisions on, in particular, dispute resolution and officer eligibility. This in turn would mean:

- greater risk of resources being wasted within those societies on attempting to resolve disputes using constitutions that do not facilitate such resolution; and
- greater risk of officers being appointed that suffered some impairment compromising their ability to make well informed decisions.

Consultation

During the MBIE 2015-2016 consultation, there was no comment on the staggered approach taken by the Draft Bill. During the targeted MBIE consultation of 2018, most submitters spoken to could see the advantage of a single transition period.

Option (ii) - shorter transition period

Key features

Under this option, the two periods of grace are reduced from (at least) two years each, to (at least) one-year each. As a result, the overall transition period, though remaining staggered, would be reduced to (at least) two years.

Impact on problem

Option (ii) would effectively address the problem of churn. In the experience of the Companies Office, it would be unusual if a majority of members of a committee were no longer in office within a two-year period.

The option would have no impact on the problem of confusion amongst incorporated societies, as

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the period of transition would remain staggered (two periods of at least 2 years).

Risks

Switching to a shorter transition period would make it more difficult for a number of incorporated societies to adapt to the new statute, ahead of the new statute coming into force. Societies most likely to be affected are those that are very small (and so lack the resources to undertake the changes quickly) and those that are very large (for whom organising the necessary general meetings is a logistical challenge). Many such societies may end up transitioning to the new regime with a non-compliant constitution. This will in turn risk creating an additional enforcement burden on the Companies Office, as it attempts to root out the non-compliance over time.

Consultation

During the MBIE 2015-2016 consultation, most of the societies who submitted on the issue appreciated the minimum four-year period in the Draft Bill's transition provisions. They felt that the long transition period reflected the prevalence of volunteers and the need to give them time to modify their constitutions.

Some submitters disagreed. For example, the law firm Sue Barker Charities Law suggested 3 years might be more appropriate. The firm stated: "Turnover of officers of incorporated societies can be high. Many constitutions set terms for officers of 3 years, or even less... If the proposed legislation is … enacted in 2018 and does not come fully into force until 2022, there may be a very high turnover of incorporated society governance… This may lead to a corresponding gap in continuity of institutional knowledge."

During the targeted MBIE consultation of 2018, most submitters spoken to could see the advantage of a shorter transition period, especially if there remained the possibility of being "restored" to the new register if a society needed more than two years.

Option (iii) – single, shorter transition period

Key features

This option combines the two previous options. The staggered approach would be abandoned, and the length of the transition period would be reduced from a minimum of four years to a minimum of two years. This would mimic the approach of the jurisdiction of British Columbia, which reformed its version of the Incorporated Societies Act in 2016, and gave societies a single period of 2 years to transition.[15]

Impact on problem

Option (iii) would effectively address the problem of confusion amongst incorporated societies. There would no longer be any need for the society to work out (or pay a professional to work out) what obligations have to be complied with and in what order.

Option (ii) would also effectively address the problem of churn. In the experience of the Companies Office, it would be unusual if a majority of members of a committee were no longer in office within a two-year period.

Risks

Option (iii) attracts all the risks associated with Option (ii), namely the risk of societies being re-registered with non-compliant constitutions, and the attendant risk of an additional enforcement

[15] See the following website for details: https://www2.gov.bc.ca/gov/content/employment-business/business/not-for-profit-organizations/societies-act-transition

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burden for the Companies Office.

Option (iii) does *not* however attract the risks associated with Option (i), namely an additional two-years during which certain key obligations (e.g. on dispute resolution) remain unenforceable.

Consultation

During the targeted MBIE consultation of 2018, most submitters spoken to could see the advantage of a single, two-year transition period.

The Companies Office stated that bringing all of the provisions of the legislation into force at the same time, after two years, would (a) simplify the process for societies in transitioning and (b) simplify the communication and implementation strategies of the Registrar and reduce their associated costs.

MBIE has determined that Option (iii) has the best cost-benefit profile. We have therefore proceeded to analyse whether this option – a single, two-year transition period – should proceed according to the current drafting of the status quo (automatic re-registration) or not, noting the problems associated with the status quo (substantial numbers of societies on the new register having non-compliant constitutions and ineligible officers).

Two alternative options (automatic re-registration with extra funding, or active re-registration by societies) have been assessed.

Option (a) – automatic re-registration with extra funding

Key features

Under this option, existing societies would be automatically transitioned to the new regime (as the Draft Bill currently provides), but extra funding would be made available for the Registrar to deal with the substantial numbers of societies on the new register having non-compliant constitutions and ineligible officers. This would be funding above and beyond the $4.072 million currently being sought to ensure a smooth roll-out of the replacement Act (see section 3A above).

Impact on problem

Option (a) would help manage the problem by providing additional resources to the Registrar, to deal with non-compliant constitutions. The funding could allow the recruitment of additional staff to conduct random audits of the constitutions of the 23,000+ automatically re-registered societies and, in cases where non-compliance is found, begin the enforcement process. The extent of the impact on the problem will depend on the amount of additional funding made available. The Companies Office estimates that, to enable an effective level of detection and enforcement, significant additional operational funding would be necessary.

Risks

This option would mean societies that have become inactive nevertheless become re-registered. These societies will not update their constitutions or provide any officer details, which:

- creates a (pointless) enforcement burden that would not exist if societies had to actively re-register;
- would also mean that users of the register could not be certain that a registered society remains active.

Consultation

MBIE has not consulted widely on the idea of increasing (beyond $4.072 million) the funding to be

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requested for implementing the new statute, in order to deal with the detection of non-compliant constitutions. However, the Companies Office does not support his option.

Option (b) – active re-registration required

Key features

Under this option, existing societies would *not* be automatically transitioned to the new regime. Instead, they would be required to actively re-register during the single, two-year transition period. This would mimic the approach of the jurisdiction of British Columbia, which reformed its version of the Incorporated Societies Act in 2016, and required societies to make a transition application.[16]

At the end of the transition period, the 1908 Act would become fully repealed and, as a consequence, the 1908 register would cease to exist (and any societies still on it will cease to benefit from the incorporation status it provides). The Draft Bill would continue to contain a 'restoration' provision (currently clause 137) so that, if a society fails to re-register under the new Act within the transition period, it can later apply to be 'restored' (as the same society) to the new register. The Registrar would retain the discretion to refuse such a request (in which case, the society would need to apply for incorporation as a new society). The assets of societies that are not restored could be dealt with by way of the direction process currently set out in section 27 of the 1908 Act.

Impact on problem

Under option (b), we expect many fewer non-compliant registrations and so significantly less of an enforcement burden for the Registrar. This is for two reasons.

First, a transition that requires active re-registration will necessarily lead to fewer attempts at re-registration. A large number of societies will not try to re-register because they have become inactive, or because they decide that incorporation is no longer worth the administrative burden.

Second, existing societies that do try to re-register will know that if they do not update their constitutions and officer details then they will face a risk of that re-registration being rejected. Although the Registrar will not be able to inspect every constitution that is submitted during the re-registration process, it will be able to conduct random inspections, and this 'threat of discovery' will motivate compliance.

Risks

As noted above, we anticipate that a number of societies will not try to re-register because they decide that incorporation is no longer worth the administrative burden (i.e. the hassle of getting member approval to fill in, and actually filling in, a re-registration form). Those societies – a number of which may be making valuable contributions to New Zealand society – will have to try to carry on as unincorporated societies, or disband entirely. This would reduce the contribution that not-for-profit entities make to New Zealand society.

There is also some level of risk for officers of a society that might be unaware that the society has been de-registered, and continue to enter into transactions in the belief that they still enjoy limited liability. However, our understanding of case law under the Companies Act 1993 is that, upon restoration to the new register, any personal liability so incurred would be superseded by the restored society's liability.

Consultation

During the MBIE targeted consultation of 2018, officials raised the idea of a transition regime that

[16] See the following website for details: https://www2.gov.bc.ca/gov/content/employment-business/business/not-for-profit-organizations/societies-act-transition

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required societies to actively apply. There was no overt opposition to this idea, and the advantages to the Registrar were acknowledged.

MBIE has determined that Option (b) has the better cost-benefit profile.

B.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The impact of options (i), (ii) and (iii) on the problem has been assessed by reference to:

- how well the option reduces the risk of confusion amongst incorporated societies;
- how well the option reduces the risk of the government having to repeat education efforts;
- how well the option reduces the risk of societies re-registering with non-compliant constitutions;
- whether the option creates any delay to certain key obligations becoming enforceable.

The impact of options (a) and (b) on the problem has been assessed by reference to:

- whether the option reduces the number of non-compliant registrations;
- whether the option dissuades societies from staying incorporated;
- short-term funding expense to government.
-

B.3 What other options have been ruled out of scope, or not considered, and why?

An alternative to the transition period options would be to have no transition period, and simply have the new statute – and all its provisions – come into force immediately. This would, however, contradict the Law Commission's finding, accepted by the government, that a transition period was necessary for incorporated societies to adapt. It would also require the legislation to be changed to impose new rules into existing society's constitutions, rather than giving societies time to make the changes themselves. A number of stakeholders, in particular trade unions, have made it clear that they would consider such interference to be unacceptable.

No alternatives to the 'automatic versus active' re-registration options have been considered.

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Section 4: Impact Analysis

A Accounting standards for financial reports

	No action	(i) All IS-NRAC use standards + extra funding	(ii) Only IS-NRAC that meet payments threshold use standards	(iii) IS-NRAC that meet payments threshold, asset threshold, or donee status, use standards
Reduces rump of societies that cannot comply	**0**	**0** Marginal impact on the management of compliance issues	**++** Would largely eliminate the problem of non-compliance	**++** Would largely eliminate the problem of non-compliance
Reduces risk of financial mismanagement going undetected	**0**	**0** Marginal impact on the risk of non-detection	**- -** Creates a lack of visibility affecting around 40% of IS-NRAC	**-** Creates a lack of visibility, but affecting fewer IS-NRAC than under option (ii)
Short-term funding expense to govt	**0**	**-** Additional funding would be required	**0** No additional funding required	**0** No additional funding required
Overall assessment		**-** **Worse than no action**	**0** **About the same as doing nothing**	**+** **Better than no action**

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B Transitional arrangements for existing societies

	No action (staggered, four-year transition)	(i) Single , four-year transition period	(ii) Staggered, two-year transition period	(iii) Single, two-year transition period
Minimises risk of confusion amongst incorporated societies	0	++ Risk of confusion about staggered obligations is entirely removed	0 Risk of confusion about staggered obligations remains	++ Risk of confusion about staggered obligations is entirely removed
Minimises risk of repeating education efforts	0	0 Risk remains of needing to repeat education due to churn	+ Risk of having to repeat education is reduced	+ Risk of having to repeat education is reduced
Minimises risk of societies re-registering with non-compliant constitutions	0	0 Risk of societies struggling to make changes within transition period is the same as under status quo	- Some societies may struggle to make constitution changes within 2 years	- Some societies may struggle to make constitution changes within 2 years
Avoids delay to certain key obligations becoming enforceable	0	- - Key obligations would not come into force until (at least) two years later than under the status quo	+ Key obligations would be introduced one year earlier than under status quo	0 Key obligations would be introduced at the same time as under status quo (after a period of at least two years)
Overall assessment		0 **About the same as doing nothing**	+ **Better than no action**	+ + **Much better than no action**

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	No action (automatic re-registration)	Automatic re-registration with extra funding	Active re-registration required
Fewer non-compliant registrations	**0**	+ Would not result in fewer non-compliant constitutions, but would enable Registrar to better manage the problem.	++ Would result in fewer non-compliant constitutions, as inactive societies will not re-register, and other societies will have incentive to make constitutions compliant
Avoids dissuading societies from staying incorporated	**0**	**0** No dissuasive effect on societies wishing to remain incorporated	- Some societies will be put off by extra requirement to file re-registration
Short-term funding expense to govt	**0**	- Additional funding would be required	**0** No additional funding required
Overall assessment		**0** **About the same as doing nothing**	+ **Better than no action**

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Section 5: Conclusions

A Accounting standards for financial reports

A.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?
In terms of exemption options, Option (iii) has been identified as superior to no action, and to Options (i) and (ii). Option (iii) is that IS-NRAC that meet an payments threshold of $10,000 per annum, that meet an asset threshold of $30,000, or that have donee status, must use the new standards. As noted earlier, the External Reporting Board and some respondents to the public consultation (mostly accountants and auditors) are in favour of all incorporated societies using the External Reporting board standards. Their concerns have been considered and were ultimately outweighed by other factors.

A.2 Summary table of costs and benefits of the preferred approach

Affected parties	Comment	Impact	Evidence certainty
Additional costs of proposed approach, compared to taking no action			
Regulated parties	N/A	N/A	N/A
Regulators	N/A	N/A	N/A
Wider government	N/A	N/A	N/A
Other parties	Members of certain societies, and the general public (eg creditors), will not benefit from the added financial visibility that the 'no action' option would bring.	Medium	Medium
Total Monetised Cost	N/A	N/A	N/A
Non-monetised costs		Medium	Medium
Expected benefits of proposed approach, compared to taking no action			
Regulated parties	Reduced compliance costs for societies falling outside the threshold	Medium	Medium
Regulators	Would largely eliminate the problem of non-compliance, reducing burden on regulator	Medium	Medium
Wider government	N/A	N/A	N/A
Other parties	N/A	N/A	N/A
Total Monetised	N/A	N/A	N/A

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Benefit			
Non-monetised benefits		Medium	Medium

A.3 What other impacts is this approach likely to have?

N/A

A.4 Is the preferred option compatible with the Government's 'Expectations for the design of regulatory systems'?

This question is not well adapted to the proposal discussed, as the proposal is simply an amendment to a Draft Bill which has already been considered in a separate RIS.

However, MBIE considers that the proposal to amend the Draft Bill so that the requirement to use new accounting standards is limited to IS-NRAC that exceed certain thresholds (annual payments, assets, and donee status) is such that the Draft Bill remains compatible with the Government's Expectations for Good regulatory Practice (April 2017) and in particular its Part A: Expectations for the Design of Regulatory Systems.

In this regard, the Draft Bill, as amended, continues:

- to have clear objectives;
- to seek to achieve those objectives in the least-cost way;
- to be flexible enough for regulators (namely the Registrar of Incorporated Societies);
- to be likely to produce predictable and consistent outcomes for regulated parties;
- to be well-aligned with related regulatory systems (notably the charities system);
- to conform to established legal and constitutional principles and the Treaty of Waitangi;
- to be clear and easy to understand; and
- to have scope to evolve.

B Transitional arrangements for existing societies

B.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?

In terms of the nature and length of the transition period, Option (iii) has been found to be the best approach. This is because:

- by eliminating the staggered approach, it removes the risk of confusion amongst societies about when certain obligations enter into force; and
- by reducing the timeframe for transition, it reduces the risk of the Companies Office having to repeat its education efforts due to officer churn, and reduces the cost to the Companies Office of managing two registers.

In terms of automatic (passive) re-registration versus active re-registration, option (b) has been identified as the best option. This is because it would result in fewer non-compliant constitutions being registered, and because it would require no additional funding (beyond the funding already included in the counterfactual). It would also enhance to cost-effectiveness of the Companies Office education campaign, as its efforts could (after the initial grace period) focus on societies that fail to re-register by the transition deadline.

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B.2 Summary table of costs and benefits of the preferred approach

Affected parties *(identify)*	**Comment**: *nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks*	**Impact** *$m present value, for monetised impacts; high, medium or low for non-monetised impacts*	**Evidence certainty** *(High, medium or low)*
Additional costs of proposed approach, compared to taking no action			
Regulated parties	Some societies may struggle to make constitution changes within 2 years. Some societies will be put off by extra requirement to file re-registration.	Medium	Medium
Regulators	N/A	N/A	N/A
Wider government	N/A	N/A	N/A
Other parties	N/A	N/A	N/A
Total Monetised Cost	N/A	N/A	N/A
Non-monetised costs		Medium	Medium
Expected benefits of proposed approach, compared to taking no action			
Regulated parties	Risk of confusion about staggered obligations is removed.	Medium	Medium
Regulators	Risk of having to repeat education is reduced, since there will be less officer churn to contend with. Would result in fewer non-compliant constitutions/register details, as inactive societies will not re-register, and other societies will have incentive to make constitutions compliant. This will reduce the enforcement burden.	Medium	Medium
Wider government	N/A	N/A	N/A
Other parties	N/A	N/A	N/A
Total Monetised Benefit	N/A	N/A	N/A
Non-monetised benefits		Medium	Medium

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B.3 What other impacts is this approach likely to have?
N/A

B.4 Is the preferred option compatible with the Government's 'Expectations for the design of regulatory systems'?
This question is not well adapted to the proposal discussed, as the proposal is simply an amendment to a Draft Bill which has already been considered in a separate RIS. However, MBIE considers that the proposal to amend the Draft Bill so that existing societies have a non-staggered, (minimum) two-year transition period, and must actively apply for re-registration, is such that the Draft Bill remains compatible with the Government's Expectations for Good regulatory Practice (April 2017) and in particular its Part A: Expectations for the Design of Regulatory Systems. In this regard, the Draft Bill, as amended, continues: - to have clear objectives; - to seek to achieve those objectives in the least-cost way; - to be flexible enough for regulators (namely the Registrar of Incorporated Societies); - to be likely to produce predictable and consistent outcomes for regulated parties; - to be well-aligned with related regulatory systems (notably the charities system); - to conform to established legal and constitutional principles and the Treaty of Waitangi; - to be clear and easy to understand; and - to have scope to evolve.

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Section 6: Implementation and operation

6.1 How will the new arrangements work in practice?
For both A (Accounting standards for financial reports) and B (Transitional arrangements for existing societies), the proposals will be implemented by the issuing of drafting instructions to PCO. PCO will amend the Draft Bill accordingly. Once the Draft Bill becomes a statute and enters into force, it will be up to the Companies Office (and more specifically the Registrar of Incorporated Societies) to oversee the correct choice of accounting standards by IS-NRAC and to oversee the transition of existing societies to the new register. The Companies Office has not identified any concerns about their ability to implement the proposals in a manner consistent with the Government's Expectations for Regulatory Stewardship by Government Agencies (and in particular the section of 'Good regulator practice'). The new regime will come into force after a single grace period of at least two years. As noted earlier in this RIS, MBIE considers that this allows sufficient preparation time for regulated parties (existing societies), especially given the availability of a procedure for restoration to the register, for societies that nevertheless fail to meet the timeframe requirements (while acknowledging that restoration would entail a fee to the society concerned) .

6.2 What are the implementation risks?
For A (Accounting standards for financial reports), the proposal for an exemption for certain societies will be of relatively simple implementation, because it involves forbearing from imposing stricter regulatory requirements. However, it will require IS-NRAC to determine, and the Companies Office to include in its random audits of IS-NRAC register details, an assessment of whether the IS-NRAC qualifies for the exemption. This will involve examining the IS-NRAC's annual payments, assets, and donee status. Some IS-NRAC may find this confusing, and the Companies Office may find it resource-intensive. The risk of confusion to some IS-NRAC can be mitigated by including information about the thresholds in the large-scale, multi-year education plan that MBIE will be running alongside the Companies Office. The risk to the Companies Office could be managed by requesting additional funding, although the risk is not so certain that such a request could be justified at this stage. For B (Transitional arrangements for existing societies), the concerns about implementation have been outlined earlier in this RIS. In particular, switching to a shorter transition period would make it more difficult for a number of incorporated societies to adapt to the new statute, ahead of the new statute coming into force. Societies most likely to be affected are those that are very small (and so lack the resources to undertake the changes quickly) and those that are very large (for whom organising the necessary general meetings is a logistical challenge). Many such societies may end up applying to transition to the new regime with a non-compliant constitution, and if this is picked up by the Companies Office, the application could be declined. This risk is mitigated by the existence of a 'restoration' process in the Draft Bill. If a society is unable to re-register because of a non-compliant constitution, it will still have the opportunity to be "restored" to the new register as the same society. The Companies Office will also will also have a targeted communications plan in place to engage societies which have not yet re-registered before the transition period ends.

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Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

Because many of the impacts anticipated are for new obligations (using certain accounting standards, transitioning to the new regime), there is no past conduct against which the success of the proposals can be measured. For example, it will not be possible to say that, before the changes, the Companies Office spent X staff-hours dealing with failures to use the External Reporting Board standards, and after the changes, Y staff-hours.

Instead, assessment of the effectiveness of the proposals will depend on qualitative feedback from incorporated societies and from the Companies Office.

The concomitant introduction of a new registry computer system, which will allow us to view aggregated information about incorporated societies for the first time, will however allow MBIE to monitor future changes much more accurately, in a quantitative fashion.

MBIE has not identified any concerns about its ability to implement the proposals in a manner consistent with the Government's Expectations for Regulatory Stewardship by Government Agencies (and in particular the section of 'Monitoring, Review and Reporting on regulatory Systems').

7.2 When and how will the new arrangements be reviewed?

A formal review of the new arrangements is not expected. However, the implications of all changes will be monitored as part of routine regulatory system stewardship.

Stakeholders will have the opportunity to raise concerns during the select committee process.

A review of the new arrangements might be required if the transition to the new regime proves much more disruptive than anticipated. This is considered a low risk.

MBIE will also be studying the conclusions of the External Reporting Board's upcoming review of the New Zealand Accounting Standards Framework, to assess the implications, if any, for the proposals. The External Reporting Board has a strategic objective of conducting a post-implementation review of the New Zealand Accounting Standards Framework in the 2019/2020 period, to ensure its multi-standards, multi-tiered user-needs approach for setting accounting standards continues to be appropriate from 2021 onwards. Later this year the External Reporting Board is expected to issue a project plan to clarify the intended scope and timeframe for the post-implementation review.

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