FINANCIAL REPORTING

TIER 3 AND 4

ADVANCED ITEMS

Financial Reporting-Topics to Cover

Depreciation-Where are we at?

Revaluation of Land and Buildings

Service Performance Report – Outcomes and Outputs

Commitments

Related Parties

Designated Funds-Accounting Treatment

If time permits - Investments

Introduction

Financial reporting is a large topic

Some parts are easy some parts are complex

Tier 3 Standard is only 60 pages

Tier 4 Standard is only 30 pages

They are not as “simple” as one thinks

Need to focus our attention on achievable targets

Charities Services have some useful information on their website and blog site

Depreciation

Only affects Tier 1, 2 and 3 reporting entities. We will deal ONLY with Tier 3.

Depreciation is *"The **allocation of the cost** of the asset **over its useful life** using a **structured method** such as **straight line** or **diminishing value**".*

Please note that the definition takes **no account of any residual value** so in effect the Tier 3 standard allocates the whole cost of the asset over its useful life without consideration of its residual value. From a practical point of view we know that in most cases there is a residual value associated with a building.

Within the Methodist Church we use the structured method called "straight line" rather than "diminishing value", so I will focus upon that method.

Depreciation

The term “straight line” is not defined within the Tier 3 Standard (really helpful for non accountants!!!!)

However there is an Explanatory Guide A5 called “Optional Template and Associated Guidance Notes for Applying Public Benefit Entity Simple Format Reporting – Accrual (Not-For-Profit)”.

While A5 is non binding and simply a guide, given the absence of a definition within the Tier 3 Standard, it is a starting point and only that. Once again the term “straight line” is not defined., once again, not too helpful.

But the guide does provide that entities that are currently depreciating their assets using the tax depreciation rates provided by the IRD can continue to do so.

Depreciation – Tax Rates

Up until 2010 tax entities have been able to claim a depreciation tax expense on buildings. In the main the depreciation rate applied was 2% and this assumed that the life of the building was 50 years (the depreciation rate for buildings is different depending on the construction of the building).

However, analysis of New Zealand building price data between 1993 and 2009 shows that, on average, buildings have actually been increasing in value. This suggests that the 2% depreciation rate is not appropriate.

The annual depreciation rate for buildings has been set to 0% if they have estimated useful lives of 50 years or more, as determined by the Commissioner of Inland Revenue.

From the 2011-12 income year, depreciation on buildings has reduced to 0% where buildings have an estimated useful life of 50 years or more. This applies to both commercial and residential properties including leasehold property.

Do we have to depreciate buildings? – Answer is "Yes" we have to provide for depreciation for buildings in our accounts. The question is "how much?"

Depreciation

There is an option within the Tier 3 Standard to use Tier 2 Standards. Clause 6 of the Tier 3 Standard provides:

"Where this Standard does not provide guidance on a specific type of transaction or event, the entity shall use its judgement to determine an appropriate method of accounting for that transaction type that results in the performance report providing relevant and reliable information. The entity shall refer to, and consider the applicability of, the following in descending order:

(a) The principles and requirements in this Standard dealing with similar and related transactions or events; and

(b) The definitions and concepts in the PBE Framework to the extent that they do not conflict with this Standard.

In making the judgement described above, the entity might also consider (but is not required to apply) the relevant requirements in the Tier 2 PBE Accounting Requirements dealing with the same, similar or related transactions or events."

WE WANT TO AVOID READING TIER 2 REPORTING STANDARDS IF WE ARE ABLE TO!!!!!!

Depreciation-Straight Line

Under the straight-line method of depreciation, we recognise depreciation expense evenly over the estimated useful life of an asset. The straight-line calculation steps are:

- Determine the initial cost of the asset that has been recognised as a fixed asset.
- Subtract the estimated salvage value of the asset from the amount at which it is recorded on the books.
- Determine the estimated useful life of the asset.
- Divide the estimated useful life (in years) into the initial cost to arrive at the straight-line depreciation rate.
- Multiply the depreciation rate by the asset cost (less salvage value).

(Small hint on estimated salvage value – The IRD have already determined that based on New Zealand building price data between 1993 and 2009 shows that, on average, buildings have actually been increasing in value.)

Depreciation-Straight Line-Example

We have in the accounts a church (a wooden building)and we brought the church building in to the accounts based upon the rateable value shown on the rate demand as at 1 September 2012 of $500,000 (i.e. it is our cost).

Let us assume that the IRD has done its research correctly and that based upon that research it has concluded that the value of buildings increases over a 50 year period and therefore our estimated salvage value is more than $500,000.

We also expect that we will get 30 years of use before any major renovations would be required.

Based upon this information, we expect that we need to expense $0.00 at 3.33% per annum (1/30th of the total amount) = $0.00 of depreciation as an expense BUT……………

Impairment…..Property …not an issue for Tier 4

When an asset is worth less in the market than the carrying amount in the statement of financial position, the difference is an impairment (and is recorded as an expense). This may occur if the asset becomes obsolete due to technological change or the asset is damaged, there has been an earthquake, the property gets flooded out or the building is not maintained.

Not only does it apply to land and buildings but also to investments, Heritage Assets, debtors, prepayments, inventories…..etc.

If you have a heritage building, is the current rateable value (our book value in the accounts) less than the market value of the building? Do you have a seismic survey report or other engineering report that shows that major work is required on the building? Is the building closed?

These questions must be dealt with at the end of each year.

Assets at revalued amounts: impairment should be factored into valuation but it may NOT be.

In most cases impairment of land and buildings will not be an issue.

Revaluation of Land and Buildings

That Tier 3 standard provides that purchased property, plant and equipment is to be measured on the cost basis. However, an entity may elect to revalue a class of property, plant and equipment.

If you wish to revalue land and buildings, you need to apply the **relevant requirements** of PBE **IPSAS 17 *Property, Plant and Equipment*,** except that you may use the current rateable or government valuation (rather than fair value as required by PBE IPSAS 17) when revaluing. Where this is the case, the entity shall disclose the source and date of the valuation in the notes to the performance report.

What are the relevant requirements of PBE IPSAS 17? We are working on these but the accounting policy needs to change, there are some additional disclosure notes required and the structure of Note 4, the Fixed Asset note in the Excel template will need to change.

Revaluation of Land and Buildings

Accounting Policy rewording….

Valuation of Land and Buildings:

(a) Measurement - Land and Buildings

Land and buildings are initially recognised at cost.

Land is subsequently carried at the revalued amount less accumulated impairment losses.

Buildings are subsequently carried at the revalued amounts less accumulated depreciation and accumulated impairment losses.

Land and buildings are revalued using rateable values on a triennial basis and whenever their carrying amounts are likely to differ materially from their revalued amounts.

(b) Other property, plant and equipment

All other items of property, plant and equipment are initially recognised at cost and subsequently carried at cost less accumulated depreciation and accumulated impairment losses.

IPSAS 17 – Disclosure Requirements

A reconciliation of the carrying amount at the beginning and end of the period showing:

- **(i) Additions;**
- **(ii) Assets classified as held for sale or included in a disposal group classified as held for sale in accordance with PBE IFRS 5 and other disposals;**
- **(iii) Acquisitions through entity combinations;**
- **(iv) Increases or decreases resulting from revaluations under paragraphs 44, 54, and 55 and from impairment losses (if any) recognised or reversed directly in net assets/equity in accordance with PBE IPSAS 21 or PBE IPSAS 26, as appropriate;**
- **(v) Impairment losses recognised in surplus or deficit in accordance with PBE IPSAS 21 or PBE IPSAS 26, as appropriate;**
- **(vi) Impairment losses reversed in surplus or deficit in accordance with PBE IPSAS 21 or PBE IPSAS 26, as appropriate;**
- **(vii) Depreciation;**
- ***(viii) The net exchange differences arising on the translation of the financial statements from the functional currency into a different presentation currency, including the translation of a foreign operation into the presentation currency of the reporting entity; and**

This wording will change this table….Note 4 – Fixed Asset Note

Note 4 – Fixed Assets

Note 4: Property, Plant and Equipment

This Year					
Asset Class	**Opening Carrying Amount**	**Purchases**	**Sales/ Disposals**	**Current Year Depreciation and Impairment**	**Closing Carrying Amount**
Land	-				-
Buildings	-				-
Motor vehicles	-				-
Furniture and fixtures	-				-
Office equipment	-				-
Computers (including software)	-				-
Machinery	-				-
Heritage assets	-				-
Total	-	-	-	-	-

Service Performance Reporting

Time to start thinking about this a bit harder then we have.

What we do just gets as “over the post”.

It is new and it goes back to governance. It is not an accounting question.

At a minimum, a statement of service performance must report on two aspects;

- outcomes
- outputs.

Tier 3 NFPs must report on both outcomes and outputs, while Tier 4 NFPs need only to report on their outputs.

Two words to remember – Significant and Relevant.

Service Performance Reporting- Outcomes

An outcome is what impact a Parish is seeking to have on its local community or society in the short to medium term. Outcomes are often confused with mission statements. Where missions are typically lofty and aspirational, outcomes are focused on the specific results the Church is attempting to achieve at a local level.

While the standards list Outcomes first and then deal with the outcomes, sometimes it is easier to look at the outputs you want to produce then ask yourself…….”Why did we want to produce those outputs?”

Example…At output for the year was we had 105 worship days so the outcome maybe “To spread the gospel of Jesus Christ” which fits nicely into the Mission of the Church.

Service Performance Reporting-Outputs

Outputs are the measureable goods and services that your Parish delivered during the year.

Outputs are usually non-financial information, such as how people were reached, or how many times you performed an activity of benefit to the wider community. The amount of money spent on a key activity may not be a worthwhile disclosure as this information will already be disclosed in the financial statements.

The question to ask is “If the Church disappeared off the face of the earth tomorrow, what would be missing from your community?” For example in a particular parish, they could run worship sessions and bible study classes weekly, they have a music group for pre-schoolers, they have a youth group for the older kids, and they are making a big impact with their budgeting courses. These are all examples of outputs. They probably do a lot more things so it is up to them to choose the most relevant and significant activities for their organisation.

You only need to report on **significant** outputs, so don’t worry about reporting on everything your Parish achieved in the year. Some significant outputs are not quantifiable, so only report quantities if it makes sense to. Otherwise, write a description. Feel free to add other relevant details or local context, if you feel this adds to your reader’s understanding.

If you require and audit or review, bear in mind that your auditor/reviewer will need to spend time understanding and testing the accuracy of the outputs presented in your SSP. This means that good record keeping for each output is crucial.

Service Performance Reporting-Charities Services

From the reports Charities Services have looked at, and the questions they have been asked, here are a few tips:

- There are no minimum or maximum numbers of outputs or outcomes. Think about what is most **relevant** and **significant** for your Parish.
- The information is meant to be non-financial and therefore supplements the financial information. It is not useful to provide the dollar value of what you spent on the output. It is more useful to know how many people you reached, or how many times you carried out the activity.
- Some outputs aren't quantifiable. Only put a quantity if it makes sense to do so. If not, just write a description.
- Outcomes are not a description of what you have done (looking back), they are a description of what you are trying to achieve (looking forward).
- Charities Services isn't judging your performance as a charity by what you put in this report. What's important is that the reader gets a really good understanding of what your parish is about and what you have been up to.

Commitments-Tier 4 and 3

Means different things in the two Standards- focus on the standard that you are reporting on.

Tier 4 - *Commitments comprise amounts owed by the entity (commonly referred to as liabilities), and legal obligations to make payments at a future date* (Definition in the Tier 4 Standard).

Tier 3 - *Contracts or similar arrangements entered into by the entity to pay money in the future* (Definition in the Tier 3 Standard).

Tier 4 Standard does not have a “Statement of Financial Position” (Balance Sheet) but has a “Statement of Resources and Commitments”

Commitments-Tier3

Commitments are legal obligations to make payments in the future. Although commitments (operating or capital) are not yet recorded as liabilities, reporting them may be essential for users of reports to gain a proper understanding of the parishes future viability(i.e. has the parish over extended itself?)

Commitments need to be reported in the notes to the performance report the **timing** and **estimated amount** of any **significant commitments** (both operating and capital). Types of commitments which may need to be reported include:

- Commitments to lease or rent assets (renting/leasing a parsonage);
- Commitments to purchase property, plant and equipment (photocopier, computer equipment, cars); and
- Commitments to provide loans or grants.

Commitments-Tier 4

- No Statement of Financial Position (balance sheet) but it has a Statement of Resources and Commitments. What is the difference? Statement of Resources and Commitments does not need to balance like a statement of Financial Position.
- The *Tier 4 not-for-profit standard* only requires the entity to record its **significant** resources and its **significant** commitments in the Statement of Resources and Commitments.

Commitments-Tier 4 – What to Include

which you can find at www.qv.co.nz.

Schedule of commitments		
Money payable by the entity*	Details of any money that your charity owes at the end of the financial year.	*Invoices received that aren't yet paid (e.g. rent payable, rates payable, utility accounts); wages and salaries including bonuses and honoraria; payments owing to IRD (e.g. PAYE); KiwiSaver contributions; interest payable; grants payable by your charity that have been approved but not yet paid; loans payable*
Other commitments*	Any other significant amounts owed to other people or organisations and not yet paid.	*Lease or rental agreement, property, plant, equipment, etc. that you have committed to pay; commitment to provide loans or grants; cash received for a future event (e.g. your charity has sold tickets at $100 for a charity dinner to be held in the next financial year)*
Guarantees*	Details and amounts of any guarantees given by your charity. Describe the nature of the guarantee, the reason why it was provided, and the maximum amount that could be paid under the guarantee.	*A charity acts as a guarantor for a loan.*

Commitments-Tier 4 – What to Include Optional

You may, but you do not have to UNLESS IT IS SIGNIFICANT, provide a breakdown of your commitments if it enhances the user's understanding of the Parishes financial position.

Money Payable by the Parish:

- Unpaid invoices (whether paid by cash or electronically such as through direct debit) relating to the provision of goods or services (for example, rent payable, rates payable and utilities accounts payable, such as, telephone, electricity and gas);
- Unpaid invoices (whether paid by cash or electronically) relating to capital activities;
- Wages and salaries due and payable, including bonuses and honoraria, annual leave;
- Cash owing to third parties relating to employees (for example, ACC levies, PAYE, and superannuation contributions such as KiwiSaver);
- GST payable;
- Interest payable;
- Loans payable; and
- Grants payable by the parish that have been approved, but not yet paid.

Other commitments:

- Commitments to make future payments under a lease;
- Commitments to purchase property, plant and equipment;
- Loans or grants the parish is legally committed to making; and
- Cash received that relates to activities to be undertaken in a future period.

Related Parties-What is it?

A related party transaction is a transfer of money, goods or services **between a charity (**the Parish or Synod, etc.) and those who are **closely associated** and have the **ability to influence the charity.**

Related Parties-Who?

Related parties can be people or organisations, including:

- people who have **<u>significant influence</u>** over the strategic and financial decisions of the Parish (such as officeholders, committee members, or managers), and close members of their families (such as a parent, partner, sibling, or child); **<u>and</u>**
- other organisations that have significant influence over the charity (for example, an organisation that appoints one of the members of the governing group of the charity).

Note: People and organisations are not considered to have significant influence if they are involved only in the day-to-day running of the charity and have no involvement in its strategic or financial decisions.

From a Parish point of view the 'elected' Officers of the charity are the Chairperson, the Parish Stewards, the Treasurer and Secretary. This is what the Law Book provides. However, in terms of the financial reporting standard, the related party also extends to the husband/wife, son/daughter, mother/father of the Officer so the circle of people who are considered to be related parties is as broad as that and no more for our purposes.

The other part of who is a related party are other entities that have significant influence over the Parish or other reporting entity.

Related Parties-Say What?

You <u>must</u> report transactions with a related party that are:

- **<u>significant</u>** to your charity (in nature or financial value), or
- **<u>not on normal terms and conditions</u>** (for example, discounted or donated goods, or discounted or volunteered professional services).

What is considered 'significant' will mean different things for different Parishes. What is considered significant for a small parish may not be significant for a larger parish. Use your best judgement to decide what is significant. Ask yourself,

> *"could including or excluding the information change a reader's understanding of your charity and its Performance Report?"*

Related Parties- Discussion

Methodist Trust Association

Church, Building and Loan Fund

Removals Fund

Board of Administration

Insurance Premiums

Designated Fund-What is it?

Designated funds are monies set aside from the **general fund** for a specific purpose. For example, your parish could decide to set aside a certain percentage of the general fund for property improvements, these funds become designated funds (internal).

Restricted funds are monies given, collected or donated for a specific purpose (external).

The big difference between designated funds and restricted funds is that the governing body can transfer designated funds back into the general funds. Restricted funds must be used for the purpose in which they were given or raised.

These are the general definitions.

Designated Funds and Reserves- Standards

In relation to the Tier 3 Standard, reserves (designated or restricted) are of two types:

- Restricted reserves which may be used only for a particular purpose (the restriction). The restriction may apply to the use of revenue from the funds such as interest received, or to changes to the capital fund, or to both.
  - To be a restricted reserve the restriction must be set by an **external party**, for example:

    (i) The express wishes of a donor (including in relation to endowment funds);

    (ii) A specific purpose agreed with a donor; or

    (iii) The terms of a fundraising appeal.
- Discretionary reserves (designated funds)that have been created by a transfer from accumulated surpluses or deficits as a decision of the parish so that it sets aside resources for a particular purpose. A feature of this type of reserves is that they may be transferred back to accumulated surpluses or deficits whenever the parish chooses.

Designated Funds

All income received and expenses relating to a designated fund **MUST** flow through the Statement of Financial Performance unless it is for the purchase of a new asset **NOT** through the designated fund.

If you are going to do this, that is use a designated fund for a specific purpose, set aside the CASH to do it, otherwise the set up of a designated fund is a waste of time (cash is king).

Example – Pipe Organ Replacement Fund.

- Funds are Received from the Congregational member
    - DR Bank (Balance Sheet)
    - CR Donations Received (Profit and Loss)
- Funds (cash) is transferred to the separate MTA Account
    - DR Separate MTA Account (Balance Sheet)
    - CR Bank (Balance Sheet)
- Transfer Funds into the Designated Fund
    - DR Accumulated Funds (Balance Sheet)
    - CR Designated Pipe Organ Fund (Balance Sheet)
- Interest Received at year end
    - DR Separate MTA Account (Balance Sheet)
    - CR Interest Received (Profit and Loss)
    - DR Accumulated Funds (Balance Sheet)
    - CR Designated Pipe Organ Fund (Balance Sheet)

Designated Funds

- Repairs to Existing Organ
  - Pay the account from the supplier

    DR Repairs and Maintenance (Profit and Loss)

    CR Bank (Balance Sheet)
  - Transfer Funds from the MTA Account to “pay back” the general bank account

    DR Bank (Balance Sheet)

    CR Separate MTA Deposit (Balance Sheet)
  - Transfer funds from the Designated Fund to the Accumulated Funds

    DR Designated Pipe Organ Fund (Balance Sheet)

    CR Accumulated Funds (Balance Sheet)
- Buy a New Organ
  - Only the first entry is different
  - Pay the account from the supplier

    DR Fixed Assets (Balance Sheet)

    CR Bank (Balance Sheet)

  Do we need to write off the old organ?????

Resources

Where do I start looking for help?

- https://www.charities.govt.nz/resources/ - Charities Services Resources Page
- https://www.charities.govt.nz/news-and-events/blog/ - Charities Services "blog site", talks on specific issues relating to topics within the standards.
- http://www.oct.org.nz/files/dmfile/NFP-reporting-guidance1.pdf - From Chartered Accountants Australia – New Zealand
- http://www.ey.com/nz/en/issues/ifrs/ey_ifrs_public-benefit-entity-accounting-standards - Ernest and Young Accountants
- https://www.xrb.govt.nz/accounting-standards/not-for-profit/ - External Reporting Board's website on reporting standards.