

# Do accounting regulators listen to their charitable stakeholders?

Rowena Sinclair \*  
Senior Lecturer in Accounting  
Department of Accounting  
Faculty of Business  
AUT University  
Auckland  
New Zealand  
[rowena.sinclair@aut.ac.nz](mailto:rowena.sinclair@aut.ac.nz)

Rebecca Bolt  
Auckland  
New Zealand

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\* Address for correspondence:  
AUT City Campus, Private Bag 92006, Auckland 1142, New Zealand

# **Do accounting regulators listen to their charitable stakeholders?**

## **ABSTRACT**

The study examines the empirical evidence of the submissions received from charitable organisations and their stakeholders in response to proposed changes to the New Zealand financial reporting framework. The study aims to determine whether an accounting regulator (in this case the New Zealand External Reporting Board) listens to their charitable stakeholders the submissions are compared with further proposals for the financial reporting framework.

Critical comparison of submission and proposal appears to show that the XRB was not listening to their charitable stakeholders. However, through the lenses of legitimacy and stakeholder theories the study found that the External Reporting Board utilised legitimacy management strategies to explain their proposals. They proactively achieved this by conforming to the environment and achieving pragmatic legitimacy in order to justify their decisions.

The study will also be of interest to a wider audience as it seeks to determine whether accounting standard setters and regulators are listening to their stakeholders something of interest to accounting standard setters and regulators in both the for-profit and public sectors.

**Key words:** Charities, Standard setters, Stakeholders, Legitimacy

# **Do accounting regulators listen to their charitable stakeholders?**

## **INTRODUCTION**

The purpose of this research study is to contribute to the body of knowledge on the charities sector; specifically regarding the attitudes of charitable entities, stakeholders and other interested parties in relation to proposed changes of financial reporting requirements (Ministry of Economic Development, 2009; Accounting Standards Review Board, 2009). The study utilises the work of Durocher & Fortin (2010) on standard-setting institution legitimacy management in assessing New Zealand's new standard setter - the External Reporting Board (XRB).

Content analysis provides a constructive methodological framework within which communication through the recorded textual medium may be studied (Krippendorff, 2004; Steenkamp & Northcott, 2007). The study examines the empirical evidence of the submissions received from charitable organisations and their stakeholders in response to the discussion papers issued on the proposed changes to the New Zealand financial reporting framework (Ministry of Economic Development, 2009; Accounting Standards Review Board, 2009). These submissions are compared with the September 2011 release by New Zealand's Minister of Commerce (2011a; 2011b; 2011c) and the XRB (2011a; 2011b) of discussion documents on further proposals for the financial reporting framework.

The financial reporting needs of charitable entities can be expected to be wide-ranging, due to the varying categories of both charitable organisations and stakeholders (Kilcullen, 2004; Tsay, & Turpen, 2011), and the associated multitude of information needs of each stakeholder group (Yetman & Yetman, 2004). In New Zealand the release of the Ministry of Economic Development (MED) discussion document *'The Statutory Framework for Financial Reporting'* in September 2009, and the release of the companion discussion document *'Proposed Application of Accounting and Assurance Standards under the Proposed New Statutory Framework for Financial Reporting'* by the independent crown authority the Accounting Standards Review Board (ASRB), provided a public forum through which the central issues of charities' financial reporting requirements could be reviewed, evaluated and discussed by the charities sector, stakeholders and the interested wider public (ASRB, 2009; MED, 2009).

It is the investigation of the attitudes of the charities sector, related stakeholders, and the interested public toward the significant issue of financial reporting that form the basis of the study. The two research questions are:

- 1. How do accounting standard setters and regulators derive appropriate financial reporting standards?*
- 2. To what extent are charity stakeholders involved in devising standards on accounting reporting and regulation?*

The methodology of stakeholder analysis has been one of the key tools of non-governmental, including charities, accountability (Slim, 2002). Stakeholder theory helps to understand accountabilities to multiple stakeholders (Collier, 2008). By comparing the consultation documents to the attitudes expressed by the charities sector and its interested bodies it is hoped to gain an indication of whether accounting regulators have taken charity stakeholders' views into consideration in developing the September 2011 consultation documents from the Minister of Commerce (2011a; 2011b; 2011c) and the XRB (2011a; 2011b). The actions taken by the XRB will also be considered through the theoretic lens of legitimacy.

The study will be of interest to a wider audience as it seeks to determine whether accounting standard setters and regulators are listening to their stakeholders something of interest to accounting standard setters and regulators in both the for-profit and public sectors.

This paper is organised as follows: first the literature is reviewed before the research method particularly the data analysis are explained. Next the findings in relation to the two research questions are considered, before a discussion of the thematic analysis through the theoretical lens of legitimacy and stakeholder and then a conclusion of the paper is undertaken.

## **LITERATURE REVIEW**

Firstly the terminology used in the study is clarified before reviewing charities' regulatory and conceptual framework in Australia; England and Wales; the International bodies and New Zealand. Next standard-setters' stakeholders and the literature on standard-setters are analysed.

### **Terminology used in the sector**

The study utilises two terms; not-for-profit (NFP) and public benefit, which both include charities. These two terms are next explained.

## ***Not for Profit***

There are numerous definitions for NFP, including Dunn and Riley's (2004, p. 646) very simple definition: "organisations that commit themselves to applying their assets only to their chosen purposes, and not to distribute their assets to their owners".

CPA Australia (2007) undertook extensive research on defining a NFP entity and identified nine criteria that participants in the research considered met the definition (Kilcullen, Hancock & Izan, 2007). Meanwhile, the United Nations commissioned the Johns Hopkins Comparative Nonprofit Sector Project (JHCNSP) to define and measure the size of NFP organisations. The JHCNSP (2003) proposed a definition with only five, rather than nine, criteria, namely the entity: (1) has an organisational structure; (2) is NFP; (3) is institutionally separate from government; (4) is self-governing; and (5) is non-compulsory.

Morris (2000) does highlight some deficiencies in the JHCNSP definition, such as the exclusion of mutual aid organisations, but she notes it is still the most widely recognised definition for NFP and the one predominantly used in New Zealand. It is also utilised by New Zealand's MED in their discussion document the 'Statutory Framework for Financial Reporting' (MED, 2009).

To consider the position of charities within the NFP sector it is useful to look at the JHCNSP's split of the NFP sector into the International Classification of Non-profit Organisation (ICNPO) groups (JHCNSP, 2003; Salamon, 2010). The New Zealand working party (Tennant, Sanders, O'Brien & Castle, 2006) applied these splits to New Zealand (Refer *Table 1*). If applicable, the Charities Register's registration number (CC) is incorporated into *Table 1*.

**Table 1 Categories of NFP institutions**

<i>ICNPO Groups</i>	<i>New Zealand example</i>
Sport, Recreational and Cultural	Gymsport Assist Trust (CC11015)
Education and research	Action Education Incorporated (CC24073)
Health	Plunket Society ( <i>registered by Region</i> ) Auckland Central Branch (CC26468)
Social services, and emergency/relief	Barnardos New Zealand (CC2184)
Environmental, animal protection	Royal New Zealand Society for the Prevention of Cruelty to Animals ( <i>registered by Region</i> ) Auckland (CC36223)
Development and housing	Compassion Housing Limited (CC10104)
Civic and advocacy groups	Consumers Institute – <i>Not a charity as advocacy is not a charitable purpose.</i>
Philanthropic and other intermediaries	Lion Foundation (CC37988)
International organisations, aid and relief	World Vision New Zealand (CC25984)
Religious congregations and associations	Anglican Church ( <i>registered by Diocese</i> ) the Diocese of Auckland (CC31449)

Unions, business and professional associations	Otago Federated Farmers Charitable Trust (CC42224)
Not elsewhere classified	Arowhenua Whanau Services (CC34799)

The NFP sector can also be split into other components which do not clearly delineate charities, such as public benefit which is discussed next.

### **Public benefit**

Accounting standards in New Zealand do not refer to either charities or NFP but use the term 'Public benefit entities'. Public benefit entities (PBE) are defined in the New Zealand International Accounting Standard (IAS) 1 paragraph 11.2 as:

*Reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders (XRB, 2011c).*

PBE is utilised by both the ASRB (2009) and the XRB (2011a, 2011b). In New Zealand, the link between public benefit entities and charities is seen, in the third component of what constitutes a charitable organisation links to public benefit i.e.

1. It falls within one of the four charitable purposes set out in section 5(1) of the Charities Act; and
2. It should not be aimed at creating private financial profit; and
3. It provides a public benefit (Charities Commission, 2006).

A variety of approaches exist in charities' regulatory and conceptual frameworks and those of Australia, England and Wales, and the international conceptual framework are reviewed before finally looking at New Zealand's current and future frameworks.

### **Regulatory and Conceptual frameworks**

A sound regulatory system for charities is important to maintain trust in the charities sector. Additionally, in relation to financial statements, appropriate conceptual frameworks are also needed as part of the regulatory framework. Conceptual frameworks establish the concepts, i.e. Generally Accepted Accounting Practice (GAAP) that underpins general purpose financial reporting (GPFR) for a particular sector or country.

#### **Australia**

Australia's regulatory framework has had numerous investigations that have related both implicitly and explicitly to the charities sector and the wider NFP sector (Charities Definition Inquiry, 2001; Senate Standing Committee on Economics, 2008; Commonwealth Government of Australia, 2009; Productivity Commission, 2009; Australian Treasury, 2011a, 2011b). Australia has

now moved from the 'committee stage' and is expected to establish its Australian Charities and Not-for-profits Commission (ACNC) on the 1<sup>st</sup> October 2012 (ACNC, 2012).

With regards to the conceptual framework, the publication of the report '*Disclosure regimes for charities and not-for-profit organisations*' (Senate Standing Committee on Economics, 2008), recognised that accounting standards are providing inadequate guidance on issues relating to charities. However, Australian Accounting Standards Board's (AASB) submission implies that they would "*not be inclined to look at standards specific to NFP organisations without first having an international precedent*" (Senate Standing Committee on Economics, 2008, p. 107). This is contrary to CPA Australia (2006a, p. 1) which considers that "*where the needs of NFP entities are not addressed by international bodies, suitable domestic guidance should be developed*". A second report published in 2009 on the '*Contribution of the Not-for-Profit Sector*' (Productivity Commission, 2009) again acknowledges that reporting needs improvement.

Despite issues in NFP reporting identified by studies (Ellwood & Newbury, 2006; Simpkins, 2006; Dellaportas, Langton & West, 2008; Gurd, Palmer & Wilson, 2008) Australia continues to operate under sector neutrality i.e. a single conceptual framework using International Financial Reporting Standards (IFRSs) for all sectors. The AASB has issued assistance through a document that identifies NFP requirements in the standards (AASB, 2008).

The two accounting profession bodies have also provided assistance. Firstly, the Institute of Chartered Accountants in Australia (ICAA) has tried to aid NFPs in their preparation of financial statements by producing a report of best practice for NFPs entitled '*Enhancing not-for-profit annual and financial reporting – Best practice reporting*' (ICAA, 2009). Secondly, CPA Australia had earlier also tried to assist NFPs with their report '*Financial Reporting by Not-for-Profit Entities*' (CPA Australia, 2000). However, using IFRS as the basis for preparing financial reports fails to take into account "*how radically NFPs differ from commercial entities*" (CPA, Australia, 2006b, p. 1). Two countries that have developed a conceptual framework for its charity sector are England and Wales which will be considered next.

### ***England and Wales***

In England and Wales there has been some form of Charity Commission since the 19<sup>th</sup> century (Tomlinson & McGlenn, 2004). England and Wales identified the pitiful state of charities' financial reporting nearly thirty years ago by Bird and Morgan-Jones (1981) who surveyed the published

accounts of charities in order to identify their problems. This report led to the development of a discussion paper on charities by the Accounting Standards Committee (1984).

From this discussion paper the Charity Commission developed standards which ultimately have led to the publication of the existing Statement of Recommended Practice (SORP) by the Charity Commission (2005). This SORP was last updated in 2008 to allow for the Charities Act 2006. The present day SORP has been amended several times to take into account the variety of issues that several studies have uncovered (Ashford, 1986; Hyndman & Kirk, 1988; Hyndman, 1990, 1991; Hines & Jones, 1992; Williams & Palmer, 1998; Connolly & Hyndman, 2000, 2001; Palmer, Isaacs & D'Silva, 2001; Charity Finance Directors' Group, 2003). The SORP is also supported by the Charities (Accounts and Reports) Regulations 2008, which prescribes the form and content of charities' financial statements, including notes. However, the SORP and the Regulations will need to take into account the Charities Act 2011 which came into effect March 2012.

Meanwhile the Accounting Standard Board (ASB) has developed a '*Statement of Principles for Financial reporting for public benefit entities*' (Accounting Standards Board, 2007). This statement sets out the principles the ASB considers underlie the preparation and presentation of general purpose financial statements for public benefit entities, including charities. Whilst the Charity Commission appears to be the driver for better standards, rather than the accounting profession, this is misleading as although the ASB no longer prepares the SORP their influence over its continuing development is considerable. This is reflected by their attendance at every SORP Committee meeting, and as well, the SORP must be approved by the ASB before it can be published (Hyndman & McMahon, 2010). This ensures that the SORP and the ASB's interpretations are compatible, further enhancing the charities sector's conceptual framework in England and Wales. Next, the international conceptual frameworks and their applicability to the charities sector are considered.

### ***International Standard Setters***

There are now two international conceptual frameworks, one for the first sector (profit) and one for the second sector (public), which will be looked at next before investigating the gap in conceptual frameworks for the third sector which includes charities.

#### ***FIRST SECTOR – PROFIT MAKING ORGANISATIONS***

The International Accounting Standards Board (IASB) is the standard setting body of the International Accounting Standards Committee Foundation. The IASB's objective is to develop

international financial reporting standards (IFRS) which *“provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity”* (IASB, 2010, paragraph OB2). The relevance of this sector to the Australia and New Zealand conceptual frameworks is that the standards developed by the IASB are currently utilised in Australia and New Zealand for their sector neutral conceptual frameworks. However, they are primarily developed for capital market decision making which is not relevant for either the 2<sup>nd</sup> or 3<sup>rd</sup> sector.

#### *SECOND SECTOR – PUBLIC SECTOR ORGANISATIONS*

The International conceptual framework for the public sector is determined by the International Public Sector Accounting Standards Board (IPSASB) within the International Federation of Accountants (IFAC). The IPSASB’s objectives of financial reporting by public sector entities are to *“provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes”* (IPSASB, 2010, paragraph 2.1). IPSASB develop International Public Sector Accounting Standards (IPSAS) based on the IFRSs produced by the IASB, thus ensuring the convergence of both international frameworks. When developing new standards the IPSASB first looks at whether there is an appropriate IFRS and then determines whether identified public sector issues warrant departures from the IASB document (IPSASB, 2008). In certain cases there will be concepts in the public sector which have no equivalency in the for-profit sector, such as revenue from non-exchange transactions e.g. donations. If this is the case a separate standard will be developed (IPSASB, 2006). Schollum (2008) considers that more countries are likely to adopt IPSASs for use by their public sector entities which will increase the usability of these standards. As Perry (2009, p. 26) states the *“IPSASB is at a stage where the standards being produced are of a sufficiently high level that they could be adopted in New Zealand”*.

#### *THIRD SECTOR - CHARITIES*

A big gap in the international sector is the absence of any conceptual framework for charities or private NFPs. However, this has been acknowledged and members of the accounting standard-setting bodies in Australia, Canada, England and Wales and New Zealand have published a report (Australian Accounting Standards Board, Canadian Accounting Standards Board, Financial Reporting Standards Board & Accounting Standards Board, 2008) that highlights the key NFP issues in the IFRS conceptual framework. Next, the regulatory and conceptual framework existing and proposed in New Zealand will be considered.

## ***New Zealand***

As with Australia, New Zealand has had a series of working parties which recommended the establishment of a Charities Commission (Working Party on Charities and Sporting Bodies, 1989; Accountability of Charities & Sporting Bodies Working Party, 1997; Working Party on Registration, Reporting and Monitoring of Charities, 2002a; 2002b; & 2003).

Whilst ahead of Australia in terms of specific regulation of the charities sector, compared to England and Wales, New Zealand's regulatory framework for charities is in its infancy, with the enactment of the Charities Act 2005, which established the Charities Commission (Cordery & Baskerville, 2007). Unfortunately the New Zealand government in its rush to save monies has proposed that the Charities Commission be disestablished and its functions absorbed into the Department of Internal Affairs (New Zealand Government, 2011). Not having an independent entity could be a backward step in New Zealand's regulatory framework and the sector is fighting the part 3 of the Crown Entities Reform Bill 332-1 decision (Association of Non-Government Organisations of Aotearoa, 2012; Cordery & Sinclair, 2012; Social development partners, Philanthropy New Zealand & The Bishop's Action Foundation, 2012).

### ***CURRENT CONCEPTUAL FRAMEWORK***

New Zealand currently follows a sector-neutral philosophy in that there is one set of GAAP requirements for all entities. Since 1<sup>st</sup> July 2011 the New Zealand Accounting Standards Board (NZASB) has delegated authority from the XRB Board to develop or adopt and issue accounting standards for GPFR in New Zealand. New Zealand GAAP is currently based on the IFRSs produced by the IASB unless there are very strong reasons why they should not be (External Reporting Board, 2011d).

However, there has been increasing calls for change due to many NFPs, including charities, not complying with GAAP. This assertion of non-compliance is supported by several New Zealand studies which have identified numerous problems with charities' financial reporting (Rees & Dixon, 1983; Newberry, 1992, 1994, 1995; Hooper, Sinclair, Hui, & Mataira, 2008; Not-for-Profit Sector Advisory Committee, 2009; Sinclair, 2010; Cordery & Patel, 2011). Compounding these problems was the study by Bradbury and Baskerville (2008) who found that a considerable amount of public benefit guidance has disappeared from GAAP and that the move to IFRS has slowed progress on public benefit financial statement issues, including those of charities. To save sector neutrality Van Peurseem (2006, p. 1) considers there is a need for "*distinct standardisation where conceptual*

*differences apply*". New Zealand is currently on the cusp of a new era in the financial statements of charities and this will be discussed next.

#### FUTURE CONCEPTUAL FRAMEWORK

On 30 September 2009 the MED, the government department that has control over the Financial Reporting Act, and the ASRB, who at that time approved (but did not develop) financial standards, each published a discussion document on a proposed new statutory framework (ASRB, 2009; MED, 2009). The documents continued the tier-approach (refer *Table II*) of the previous reviews' reports (MED, 2004a, 2004b). Both documents requested submissions which are analysed in the study.

**Table II Proposed Tiers of Accounting Standards to PBE Sectors (adapted from ASRB, 2009)**

<i>Tiers Based Upon Operating Expenditure</i>	<i>Reporting standards proposed</i>
<i>Tier 1:</i> Operating expenditure $\geq$ NZD10 million.	Full Public Benefit Entity Accounting Standards; a not-for-profit application of IPSAS. Expected to include financial statements and service reporting.
<i>Tier 2:</i> Publicly accountable entities (or those with $\geq 10$ members) with expenditure $\leq$ NZD10 million but $\geq$ NZD1 million. Entities with expenditure $<$ NZD1 million but $\geq$ NZD20,000 which are issuers.	Differential Public Benefit Entity Accounting Standards based on above. Expected to include financial statements and service reporting.
<i>Tier 3:</i> Publicly accountable entities (or those with $\geq 10$ members) with expenditure $\leq$ NZD1 million but $\geq$ NZD20,000.	Simple Format Reporting based on accrual accounting. Expected to include financial statements and simple service reporting.
<i>Below Tier 3:</i> Equal to or Less than \$20,000	No reporting required

Two years later in September 2011 the Minister of Commerce (2011a; 2011b; 2011c) released the following three documents:

- *Regulatory Impact Statement: The Review of the Financial Reporting Framework;*
- *Review of the Financial Reporting Framework: Primary Issues;*
- *Review of the Financial Reporting Framework: Secondary Issues.*

These releases were followed by the XRB, who took over the ASRB's standard-setting duties, releasing their accounting standards framework which proposed abandoning sector neutrality and adopting a multi-standards transaction neutral approach (XRB, 2011a). This was accompanied by a discussion paper proposing the accounting standards framework for PBEs (XRB, 2011b). These are the documents that will be used in the study to compare against submissions received on the 2009 MED and ASRB discussion documents. Next, the stakeholders that the MED and XRB should be considering are identified.

## **Standard Setters' Stakeholders**

This study initially utilises Freeman's (1984) seminal definition of stakeholders as *"any group or individual who can affect or is affected by the achievement of the organisation's objective"* (Freeman, 1984, p. 46). This definition was further enhanced by Donaldson and Preston (1995) who considered stakeholders also had legitimate interests in procedural activities, in this case standard-setting.

The two international standards setters identify different key stakeholders. In the case of the IASB (2010) these are existing and potential investors, lenders and other creditors; the IPSASB (2010) considers that public sector entities are accountable to their resources providers i.e. taxpayers, donors, lenders. However, are these stakeholders that the MED and XRB should be considering?

Cooper and Robson (2006) identify accounting firms as stakeholders that are involved in regulation through both submissions and being on standard-setting boards. Lee (2004) considered that the general public was a stakeholder. He explained their interest was due to the annual cost to the public of the NFP sector, in terms of taxation deductions and exemptions.

Palmer's (2011) study identifies key stakeholder groups as: funders; sector regulators; and clients and communities. However, his study then separates submissions into three different groups: academics; legal & accounting professions and government departments; and NFPs and individuals. The first two of these groups could be called 'lobbyists' who Hanson (2011) highlight are stakeholders that must be considered.

Another group of lobbyists are academics who Larson, Herz and Kenny (2011) consider play an important role in the development of accounting standards. In fact they go further by suggesting that accounting standard development could be enhanced with greater participation from the academic community.

McCarthy (2007) highlighted the importance of identifying stakeholders in the case of standard setters. This importance is highlighted by Christensen and Mohr's (1999) who argued that if only certain types of stakeholders especially NFP organisations participate, then standards may be promulgated that are inappropriate for the 'silent majority'. In fact Larson (2007) considered that stakeholder participation is the key component for organisations to obtain legitimacy and success. It is next important to consider prior literature around standard setting organisations to identify the contribution that the study can provide to be literature.

## **Standard setting organisations**

Much of the literature of standard-setting institutions emphasise the importance of organisational legitimacy (Johnson & Solomons, 1984; Baylin, MacDonald & Richardson, 1996; Shapiro, 1997; Durocher, Fortin & Côté, 2007; Bernstein & Hannah, 2008; Durocher & Fortin, 2010). Johnson and Solomons' (1984) seminal work identified three conditions that must exist for standard-setters to be seen as legitimate: sufficient authority; substantive due process; and procedural due process. Durocher & Fortin's (2010) study utilised Suchman's (1995) legitimacy typology to assess whether organisational legitimacy existed.

Irvine & Ryan's (2010) study compares the different regulatory systems for five jurisdictions. They do this under the analytical construct of 'regulatory space'. They follow an earlier study by Young (1994) who considered regulatory space in relation to the construction of accounting issues by the United States' (US) standard-setting body, the Financial Accounting Standards Board (FASB). Irvine & Ryan (2010) determined that Canada has an uncertain regulatory space, the US a centralised regulatory space, Australia, a regulatory space vacuum {which as previously mentioned is about to change}. They consider that New Zealand had a complex and congested regulatory space with the New Zealand Institute of Chartered Accountants (NZICA) and the Charities Commission having little co-operation. As discussed previously the standard-setting environment in New Zealand has changed from NZICA to the XRB which has led to a more centralised regulatory space.

Palmer's (2011) took a different approach by considering what submissions said about the current level of satisfaction of NFP financial reporting amongst different stakeholders. This paper proposes to look at the next step i.e. what the NFP sector and their stakeholders consider about financial reporting and whether this compares to what standard-setters ultimately propose. Next the research method selected to determine this will be discussed.

## **RESEARCH METHOD**

The purpose of this research study is to contribute to the body of knowledge on the NFP sector in New Zealand; specifically regarding the attitudes of NFP entities, stakeholders and other interested parties in relation to proposed changes of financial reporting requirements. Therefore, an investigation into the attitudes of such related parties in relation to financial reporting requirements is warranted.

The key research question is “Do accounting regulators listen to their stakeholders? Two subsidiary questions are expressly addressed in the findings:

1. *What is attitude of the New Zealand NFP sector and their stakeholders towards the MED (2009) and ASRB (2009) documents?*
2. *What are the differences and similarities between attitudes expressed by the NFP sector and its stakeholders in question one, and the content of the Minister of Commerce (2011a; 2011b; 2011c) and XRB (2011a; 2011b) documents?*

It is the investigation of the attitudes of the charities sector, related stakeholders, and the interested public towards the significant issue of financial reporting that form the basis of the study. In particular how accounting standard setters and regulators derive appropriate financial reporting standards and to what extent are charity stakeholders involved in devising standards on accounting reporting and regulation.

### **Data Collection**

Reflecting the two subsidiary questions there are two types of data collection: (1) stakeholder submissions on the MED (2009) and ASRB (2009) discussion papers; and (2) documents released by the Minister of Commerce (2011a; 2011b; 2011c) and the External Reporting Board (2011a; 2011b).

#### ***MED & ASRB September 2009 Discussion papers' submissions***

Submissions received by the ASRB and MED in relation to the discussion documents released by each entity form the base data source that will be examined in this research study. Only submissions meeting the criterion of either New Zealand NFP entities, PBEs, stakeholders or interested parties will be considered in the sample.

The objective of this research study is to understand, more in-depth, the views, concerns and issues facing a particular sector (Bryman & Bell, 2007). An inherent sampling bias exists, by selecting to primarily examine the public submissions and perceptions that have been knowledgeably presented on a public forum by NFP entities, related stakeholder and interested parties. It may be the case that submissions have only been offered by those persons who feel they have a specific contribution to make to the public discussion, or who are more interested in debating the issues covered by the MED and ASRB discussion documents than the typical NFP manager, stakeholder or other person. Therefore, it must be acknowledged that the sample

selected for this research study may not be representative of the NFP sector and stakeholder population as whole.

### ***Minister of Commerce's 2011 releases & External Reporting Board 2011 Consultation papers***

The Minister of Commerce on behalf of the MED released a regulatory impact statement (2011a) and the primary (2011b) and secondary (2011b) issues arising from the review of the financial reporting framework. At the same time the XRB, which assimilates the role previously held by the ASRB, released their PBE consultation paper (XRB, 2011b) which provides further proposals in terms of the development of accounting standards and reporting requirements for PBEs.

### **Data analysis**

Taylor and Bogdan (1998) considered that qualitative data analysis is the process of inductive reasoning, thinking and theorising. However, before analysis there needed to be some form of data reduction of all the data sources collected in this research (O'Dwyer, 2004; Ghauri & Gronhaug, 2005).

This was undertaken through an inductive thematic analysis and coding of the interview transcripts utilising NVivo. The ability to gain some mastery over all of the data is one of the key benefits of using computer assisted qualitative data analysis software for data reduction (Robson, 1993; Anderson-Gough, 2004). Smith (2003) considered that qualitative data is vulnerable because, unlike quantitative data, there is an absence of established techniques for ensuring that data analysis is both complete and impartial. NVivo enhances confidence in the impartiality of the analysis because: *"(1) it provides a chain of evidence; (2) all cases are used in the evaluation; and (3) provides an analytical framework from which the research problem can be tested"* (Smith, 2003, p. 137). Hence NVivo was utilised to search, organise and track submissions.

In this research a deductive approach was taken which allowed themes to be linked to existing theories, in this case legitimacy and stakeholder, which provided a frame of reference for analysing these findings. These matters will be addressed in the research findings and discussions that are framed by the theoretical frameworks of legitimacy and stakeholder.

Two types of data analysis were undertaken qualitative document analysis of the Minister of Commerce (2011a; 2011b; 2011c) and XRB (2011a; 2011b) documents and content analysis of the submissions on the MED (2009) and ASRB (2009) discussion papers.

### ***Qualitative document analysis***

Altheide (2000) considered that qualitative document analysis permitted rich textual thematic analysis. Hence the benefit of conducting ‘documentary’ analysis on public documents is that it is possible to learn something about the organisation that writes, publishes and maintains them (Taylor & Bogdan, 1998). Through the analysis of the types of disclosures made by a public document, and what are included in said disclosures, a greater understanding of the underlying motives, perspectives and interests driving the ‘official’ organisation may be gained. As stated by Taylor and Bogdan (1998):

*‘Like personal documents, these materials lend insight into the perspectives, assumptions, concerns, and activities of those who produce them... The qualitative analysis of official documents opens up many new sources of understanding (pp. 129-130).*

Documentary analysis of the Minister of Commerce (2011a; 2011b; 2011c) and XRB (2011a; 2011b) documents may therefore be considered as an appropriate method through which the disclosures made in the consultation paper may be analysed. Unlike the content analysis of public submissions, disclosures made in the identified documents will not be coded and categorised. Rather, the overarching nature of disclosures made in the Minister of Commerce (2011a; 2011b; 2011v) and the XRB (2011a; 2011b) documents will be analysed, discussed, and reflected upon.

### **Content analysis**

Content analysis is the method through which the submissions received by the MED and ASRB, which form the base data source of this research study, have been analysed. Content analysis involves the systematic, in-depth review and evaluation of documents and texts, achieved through the use of consistent coding mechanisms (Krippendorff, 2004; Bryman & Bell, 2007). It is through the organisation and coding of secondary data into pre-determined, mutually exclusive, and exhaustive classifications (Bryman & Bell, 2007) that occurring patterns can be identified, and consequential information derived (Krippendorff, 2004; Bryman & Bell, 2007).

Content analysis results in a level of sureness about facts – the researcher simply takes the text for meaning exactly what it is i.e. only the facts present are recorded in content analysis, unbiased by the meaning behind it (Carney, 1972).

### **CONSOLIDATION OF QUESTIONS**

Before content analysis could start there was a need to identify the key questions applicable to charities. These are detailed in *Appendix 1* (MED, 2009) and *Appendix 2* (ASRB, 2009). These questions were then grouped into categories (refer *Table III*):

**Table III Content analysis categories**

<i>Question</i>	<i>Category</i>	<i>Key points</i>
MED Q15	Basis of tier splits	Annual operating expenditure
ASRB Q8	Basis of tier splits	Entity size based on expenditure used to allocate entities
MED Q16	Size of tier	Annual operating expenditure of \$20,000 and \$20 million as the cut off points between small and medium, and medium and large respectively.
ASRB Q9	Size of tier	Tier 1 should comprise entities with expenditure $\geq$ \$10 million
ASRB Q10	Size of tier	Tier 3 should comprise entities with expenditure under \$1 million
ASRB Q11	GAAP	NFP Application (building on IPSAS) as the basis for reporting in the not-for-profit sector.
ASRB Q12	GAAP	Full PBE standards should apply to Tier 1; and a differential version of the PBE standards should apply to Tier 2.
ASRB Q13	GAAP	Simple Format Reporting' should apply to Tier 3 entities.

### *CODING OF PUBLIC SUBMISSIONS*

The process followed in coding the MED & ASRB submissions were as follows:

1. The population of interest (or 'sample') is identified. This only included publically available submissions (Refer *Table IV*).
2. The nature of the 'submitter' is identified, utilising the JHCNSP (2003) and Palmer (2011) categories (Refer *Appendix 3*).
3. Submissions are then coded in accordance with the pre-determined categories (Refer *Table III*).

**Table IV Content analysis categories**

<i>Population</i>	<i>MED submissions</i>	<i>ASRB submissions</i>
Submissions	151	75
Unable to access submission	(7)	(1)
Outside Questions in <i>Table III</i>	(104)	(37)
<i>Submissions relating to Table III</i>	40	35

The aim in this research study is to code text according to their perceived intended meaning, and determine the frequency with which accounting concepts are referred to within the context of addressing both the MED and ASRB proposed changes expressed throughout each respective discussion document.

## **FINDINGS**

This section presents the content analysis undertaken on the MED and ASRB discussion document submissions, as they relate to the research questions. This section also presents the results of documentary analysis undertaken on the Minister of Commerce (2011a; 2011b; 2011c) and XRB (2011a; 2011b) documents.

### **Question One – NFP stakeholders' views of MED & ASRB 2009 discussion papers**

The section initially focuses on answering the first research question by dividing findings into the three categories identified in *Table III*:

1. *What is attitude of the New Zealand NFP sector and their stakeholders towards the MED (2009) and ASRB (2009) documents?*

Submissions are identified by the submission number allocated by either the MED or ASRB.

### ***Basis of Tier splits***

The two discussion papers (MED, 2009; ASRB, 2009) posed two questions, which relate to the basis by which the tiers would be split (refer *Table V*). These questions proposed using annual operating expenditure as the basis of tier splits.

**Table V Questions on Basis of Tier splits**

<i>Question</i>	<i>Category</i>	<i>Key points</i>
MED Q15	Basis of tier splits	Annual operating expenditure
ASRB Q8	Basis of tier splits	Entity size based on expenditure used to allocate entities

The majority of submissions made in relation to this question agree with the MED and ASRB proposals to use annual operating expenditure as the means for determining NFP entity size i.e. small, medium or large entity. Common reasons given by submitters for considering annual operating expenditure as an appropriate base included operating expenditure being considered a “*key criteria for activity levels within private non-profit entities*” (O’Halloran HMT Ltd MED 14). It was also considered that operating expenditure provided a “*better proxy for economic size than revenue in the not-for-profit sector*” (Hayes Knight MED 52).

However, concerns were raised in regards to what would constitute ‘operating expenditure’. Submissions debated whether the inclusion of non-cash expense items such as depreciation, and donated volunteer time should be included for the purposes of providing a definition of ‘operating expenditure’. The majority of submissions that discussed these issues considered that non-cash items should not be included in the definition. As stated by the New Zealand Federation of Voluntary Welfare Organisations (MED 70):

*We note that the term operating expenditure is not defined; this needs to happen so that non-cash items such as the valuation of volunteer time and adjustments for changes in value of land and financial instruments are defined as being non-operating.*

Submissions also raised concerns on the use of ‘operating expenditure’ to define tier size in the event that expenditure was non-constant from period to period. This would mean that the tier classification of the entity might change from being a small entity to a medium entity and back to

a small entity, for example, over a short period of time. Alan Spencer (MED 9) expressed this view, stating:

*The other difficulty is in dealing with the situation when the amount of such expenditure varies from year to year around the determining figure. It would be very upsetting to have EFR and Assurance obligations change from one year to the next only because of an increase of a few dollars in the amount of expenditure.*

It was suggested by the Tairāwhiti Community Law Trust (ASRB7) that it may yield more consistent PBE sector tiers if expenditure was considered as an average over a three or five year period, rather than each period independently.

However, there existed some debate as to whether expenditure alone should be the only allocation base in relation to tier size. Several entities disagreed with this aspect of the proposal, supporting the use of both expenditure and an asset 'test' to allocate entities to PBE tiers. Justification for using both expenditure and asset value as tier allocation was provided by PricewaterhouseCoopers (ASRB 70), who stated:

*In our experience not-for-profit entities can broadly be split into two categories: entities that spend all of their resources as they receive them; and asset rich entities that use the income generated from a strong asset base to support their objectives. An expenditure only criterion is suitable for the former category, but not the latter where, in our view, an asset criterion would be better.*

Several other submitters, including the New Zealand Institute of Chartered Accountants (ASRB 73) and Deloitte (ASRB 57) broadly echoed this view.

Further submissions considered neither expenditure nor asset value appropriate as a PBE sector tier allocation base. Revenue was put forward as a credible alternative, as supported by Presbyterian Support (ASRB 20) who emphasised that the nature of NFP organisations lay with the donations (i.e. revenue) which was received. The use of revenue as a PBE sector tier allocation base was reinforced by Unitec (ASRB 4) New Zealand, who considered:

*We have some concern about reliance solely on operating expenditure as a threshold for reporting tier allocation. It was considered that revenue should also be a key indicator for accountability to donors, although recognising that this measure may be less consistent.*

This subsection has presented the perceptions of submitters in relation to the proposed basis of tier splits in the New Zealand NFP sector. It was generally accepted that a tiered reporting structure was appropriate for the NFP sector. However, issues regarding the ways in which the tiers would be comprised were discussed. Of particular concern was the use of annual operating expenditure as a basis for determining tier thresholds, and what constituted 'operating

expenditure’. The next subsection focuses on the submissions relating to the size of tiers proposed.

### **Size of Tiers**

The two discussion papers (MED, 2009; ASRB, 2009) posed another three questions, on the size of each tier (refer *Table VI*). These questions proposed splitting NFP tiers at \$10 million, \$1 million and \$20,000. These splits differed from the propose Public Sector tiers at \$20 million and \$2 million.

**Table VI Questions on Size of tier**

<i>Question</i>	<i>Category</i>	<i>Key points</i>
MED Q16	Size of tier	Annual operating expenditure of \$20,000 and \$20 million as the cut off points between small and medium, and medium and large respectively.
ASRB Q9	Size of tier	Tier 1 should comprise PBE entities with expenditure ≥\$10 million
ASRB Q10	Size of tier	Tier 3 should comprise PBE entities with expenditure under \$1 million

The majority of submissions made in relation to this question disagree with the cut-off points between small, medium and large NFP entities. The MED’s lower threshold of \$20,000 annual operating expenditure was considered an inappropriate annual operating expenditure limit between small and medium size NFP entity tiers.

Common reasons given by submitters for disagreeing with the lower tier size limit included a perceived ‘*significant burden on volunteer organisations*’ (Gallagher Group Ltd MED 18), specifically referring to a perceived significant increased economic outgoing. The issue of whether there would be any added benefit to NFP entities with relatively low annual operating expenditure preparing GPFR was also raised. The availability of appropriate resources to prepare NFP general-purpose financial statements was also considered a concern, as stated by Fletcher Building Ltd (MED 49):

*Non-profit entities are not going to have qualified accountants so will likely have to pay Chartered Accountancy firms to prepare general purpose financial statements where expenditure exceeds \$20k. The cost of this will outweigh any benefits that are received.*

It was generally suggested to raise the lower tier limit for small to medium size NFP entities from \$20,000 to \$60,000 annual operating expenditure, aligning the lower tier size with the current Goods and Services Taxation (GST) registration threshold. Hayes Knight (MED 52) expressed this view, stating:

*\$20,000 appears possibly unnecessarily low for small entities. We think it would be more logical to align the small threshold to the GST registration level, i.e. \$60,000. Thresholds would need to be able to be reviewed on a regular basis to ensure they remain appropriate.*

Further suggestions supported raising the lower threshold to \$100,000 annual operating expenditure. Rationale included alignment with the proposed lower NFP sector tier assurance requirement threshold of \$100,000 annual operating expenditure (Grant Thornton MED 108). However, many submitters gave little justification as to why \$100,000 annual operating expenditure would be considered an appropriate threshold between small tier and medium tier size NFP entities, other than the proposed \$20,000 limit was 'too low'.

Submitters were divided in regards to the ASRB proposal that Tier 1 and Tier 2 have different levels for public sector entities and not-for-profit entities. Many submissions suggested that the NFP entity upper tier threshold level should be equal to that proposed for public sector entities. A key issue argued by submitters who disagreed with the ASRB discussion document proposal was that there should be no difference between upper threshold levels for those entities operating in the public sector and entities operating as NFP. As stated by Massey University (ASRB 16):

*'There is no justification for PBE and NFP sectors have different dollar cut-off points, unless it is argued that the cost of maintaining an accounting system differs between sectors.'*

The issue of the perceived 'accountability' of NFPs was also considered a concern by submitters when setting tier size. It was argued by several submitters that the 'accountability' of NFP entities was lower than public sector entities, the latter of which were generally considered to operate primarily through the use of 'coercive revenue' i.e. taxes and other 'public' monies. The accountability of the entity was therefore considered to be a significant factor in regards to tier size and external reporting requirements. As expressed by The Treasury (ASRB 66):

*In our view, donors choose to donate to charities or belong to clubs which make up a large part of the sector whereas tax payers and citizens have no choice over whether to pay their taxes and no influence over which public sector entities receive government funding. On that basis the Treasury thinks there is a difference in public accountability between public sector and the not-for-profit sector.*

However, while the 'accountability' relationship between entities and the public was considered a significant issue by submitters, submitters expressing this concern were once again divided as to what the upper tier threshold should be for NFP entities. No clear suggestion regarding upper tier size for NFP entities gained a convincing majority.

Submitters agreeing with the ASRB discussion document proposal regarding the split upper tiers for public sector entities and NFP entities gave little justification as to why they considered these

thresholds to be appropriate limits in regards to identifying medium and large public sector and NFP entities.

This subsection has presented the perceptions of submitters in relation to the proposed size of tiers in the New Zealand NFP sector. The proposed MED and ASRB thresholds for the tier 3 was an issue of particular concern. The next subsection focuses on the submissions relating to the GAAP requirements proposed.

### **Generally Accepted Accounting Practice**

The ASRB (2009) posed three questions (Refer Table VII) on the proposed GAAP for PBEs particularly which standards should apply.

**Table VII Questions on GAAP**

<i>Question</i>	<i>Category</i>	<i>Key points</i>
ASRB Q11	GAAP	NFP Application (building on IPSAS) as the basis for reporting in the not-for-profit sector.
ASRB Q12	GAAP	Full PBE standards should apply to Tier 1; and a differential version of the PBE standards should apply to Tier 2.
ASRB Q13	GAAP	Simple Format Reporting' should apply to Tier 3 entities.

Submitters were strongly against having a NFP application built on IPSAS. Three reasons were fairly consistent across submissions: (1) issue of credibility with IPSAS; (2) too costly; and (3) IFRS has served as well. The following submissions reflect this:

*IPSAS are not yet a 'credible alternative for NZ to consider. Furthermore the cost of developing local accounting standards for PBE is too high. Hence, the only alternative is to modify IFRS (Massey University ASRB 16).*

*Current PBE accounting standards under NZ IFRS have served us well in regards to preparing financial statements over the recent past (Auckland City Council ASRB 21).*

The majority of submissions agreed that full PBE standards should apply to those entities that classify as tier 1, and a differential version of the PBE standards should apply to those entities that classify as tier 2. Again, many submitters did not offer any justification as to why they agreed with the proposals outlined. Reasons given by those submitters who did provide a justification for agreeing with the proposals included a perceived increased obligation for larger entities to report:

*We agree that the more significant entities should have greater reporting obligations than less significant entities. On that basis, we agree that full standards should apply to tier 1 PBEs in the public sector (Office of the Auditor General ASRB 34).*

It was also noted by several submissions that the requirements of other organisations e.g. the Charities Commission should be taken in account when setting the differential reporting standards for NFP entities.

Where submissions disagreed with the proposed ASRB reporting framework, several concerns were expressed. Auckland City Council (ASRB 21) expressed concern that the introduction of sector-specific accounting standards would further complicate reporting requirements. Possible incompatibility with the proposed use of IPSASs was also considered an issue. Presbyterian Support (ASRB 20) considered that in the absence of a specific set of 'generally accepted' NFP sector international standards, it would not be appropriate to apply the IPSASB framework to NFP entities:

*We consider IPSAS is not appropriate for private NFPs because it is designed for public sector entities whose users have different needs. Given the small number of NFPs that would be required to report, we favour the approach of continuing to report against NZ IFRS until a system can be developed which provides better comparability within the NFP sector and that sufficiently justifies moving to a new framework (Presbyterian Support ASRB 20).*

In relation to Tier 3 requirements the majority of submissions agree with the proposal to apply 'Simple Format Reporting'. While most submitters appeared to agree with the ASRB discussion document, differing reasons were offered for agreeing with the proposal. PricewaterhouseCoopers (ASRB 70) argued that charities were publicly accountable, regardless of size, and their perceived public accountability justified the preparation and subsequent publication of 'some form of financial report'. Submitters also viewed that PBE tier 3 entities would have less complex transactions therefore simple format reporting is a more appropriate reporting framework.

The issue of what type of simple format financial report should be disclosed by those entities operating within the PBE sector was discussed in depth by many submissions. There emerged two clear arguments in relation to this issue; those who supported the implementation of a standardised reporting template and those who supported the development and use of sector specific standards for simple format reporting.

The arguments submitted supporting a standardised simple format reporting template largely centred around the perception that a standardised template would reduce the costs of the complying organisation, provide guidance in reporting, be easy for smaller organisations to understand, and therefore implement, and be easily accessible for both report issuers and users (Tairawhiti Community Law Trust ASRB 7). The arguments supporting industry specific simple format reporting standards were primarily concerned that a "one size will fit all" approach, as

implied by the use of a standardised simple format reporting template, would not meet the needs of all users of PBE financial reports. As discussed by the Office of the Auditor General (ASRB 34):

*In our view, simple format reporting could be tailored to the different types of entities that make up tier 3. There does not need to be only one simple format report to be used by all tier 3 entities. For example, there could be a simple format report for a school that is different to a simple format report for a cemetery board or a reserve board.*

This subsection has presented the perceptions of submitters in relation to the proposed accounting standard framework changes in the New Zealand NFP sector. The key points are summarised in *Table VIII*.

**Table VIII Summary of Question One**

<p><b>Basis of Tier splits</b>  <i>Majority Agreement:</i> Using annual operating expenditure as the basis of tier splits.  <i>Concerns:</i> What included in operating expenditure e.g. depreciation &amp; donated volunteer time.                  Need to average operating expenditure over 3-5 years.</p>
<p><b>Size of Tier</b>  <i>Majority Disagreement:</i> Using \$10 million, \$1 million and \$20,000.  <i>Concerns:</i> \$20,000 should be GST level i.e. \$60,000.                  Disagreement with having different levels between NFP and Public sector.</p>
<p><b>GAAP</b>  <i>Majority Disagreement:</i> Do not agree with using IPSAS as a basis for NFP application but:  <i>Agreement:</i> Tier 1 Full PBE standards; Tier 2 Differential; and Tier 3 Simple format reporting</p>

Before considering the second question two themes that were identified in the analysis relating to the tier 3 threshold and the resulting cost impact of these proposals will be analysed.

### **Tier 3 Threshold**

In all questions proposed by the MED and the ASRB where a tiered structure was suggested by the document(s), the main subject of debate by the greater part of submissions was regarding the proposed lower tier. It should be noted that this phenomenon is not a specific feature of a specific ‘classification’ of submitting entities. Submissions, relating to a number of differing entities categorised within a number of differing ‘classifications’, all showed this similar attribute.

While the MED’s proposed upper threshold of \$10 million annual operating expenditure was mentioned and discussed in a number of submissions, it was not discussed in the same depth as the ‘small’ entity threshold. It was evidenced that the majority of submissions that discussed the upper tier thresholds, whether it be proposed by the MED discussion document (2009) or the ASRB discussion document (2009), generally considered the limits for tiers 1 and 2 to be ‘reasonable’, with little other justification or debate. Consider the following submission:

*At the upper end ..... This is comparable to large companies. At the lower end \$20,000 is far too low. It represents only half the costs of employing one person (an administrator). A*

*more realistic level is the GST threshold, though this is also very low. If a NFP entity is required to regularly submit GST returns, then their general capacity for compliance and report preparation is appropriate for 'simple format reporting'. A level of \$100,000 would be better John Wallis (MED 48).*

The structure of this particular submission is typical of most submissions made in relation to this question. The lower tier MED and ASRB thresholds and their requirements have been identified as issues that the submitters have considered to be significant.

It is necessary to consider the economic environment within which the submitting entities are submitting. As identified by the Minister of Commerce (2011b) the majority of registered charities are either below tier 3 i.e. 57% of registered charities or in tier 3 i.e. 39%. These NFP entities would be significantly impacted by any changes to the current accounting standards. This may go some way in explaining the overt interest in the accounting standards requirements proposed by tier 3 entities.

Another tier 3 threshold matter of importance relates to the cost. Specifically, how the expenses of the entity may be affected by the proposals made by the MED and ASRB. The costs of complying with the MED and ASRB proposed reporting requirements for NFP entities were of particular concern. Many NFP entities were concerned with the perceived extra financial pressures that they would face as a result of greater compliance requirements. Significantly, as with the above discussion, the compliance costs of NFP entities that would classify as tier 3 under the MED and ASRB proposals was a particular area of debate. It was generally stated by NFP entities commenting on this issue, that the increased costs of complying with the proposed reporting requirements would place a significant economic burden on already strained financial resources. As identified by the Fashion Museum of New Zealand Charitable Trust (MED 27):

*Most non-profit entities have income which closely matches their operating expenses. As you identify a large number of non-profits have very small income/operating expenses. Imposing costly compliance is going to substantially impact on non-profits' already marginal financial viability.*

There was a general consensus by submitting NFP entities that the perceived costs of the proposed additional compliance requirements outweighed any potential benefit that could be gained.

However, submissions did not consider what the benefits of the MED and ASRB proposals could be for NFP entities. Indeed, what the expected additional costs to NFP entities (falling within each tier structure) was not known by many of the NFP entity submissions. It was merely emphasised in

many cases that the costs of complying with proposed increased reporting requirements should not be 'too high'. It may therefore be evidenced that the majority of NFP entity submitters are primarily concerned with the costs of additional compliance, and the impacts that the costs have on their usual operating practices. Consider the following submission by the Presbyterian Church of Aotearoa New Zealand (MED 53):

*The main criteria is that the benefits should outweigh the cost. As the proposals stand, the costs would be high. A suggestion is that the assurance cost should not exceed 1% of cash expenditure.*

Furthermore, it was argued by several NFP submissions that the majority of NFP entities were perceived to generally have limited expertise, manpower and other resources, at their disposal. The amount of time taken to prepare financial reports, and the perceived increased workload of NFP volunteers was also a subject of debate amongst submitters. The limited resources and lack of 'accounting experience' of those NFP entities falling within the tier 3 threshold was considered especially significant. These NFP entities were identified by the NFP entity submissions as potentially struggling to meet the MED and ASRB reporting and assurance proposed requirements. The Tairāwhiti Community Law Trust (ASRB 7) discusses this sentiment:

*Without some form of simple format reporting, we would be concerned about the potential for increased workloads which may fall on groups of volunteers, the time and cost involved. Filing fees, fees for financial statements, and the capacity of the accounting profession to cope with the inevitable increased workloads.*

It is hoped that the example of the England and Wales Charity Commission who adopted a proportionate approach to their work based on a risk framework is adopted (Hind, 2011). This is something to emulate if it leads to a better balancing between costs and benefits.

The next subsection focuses on answering the second research question 'What are the differences and similarities between attitudes expressed by the NFP sector and its stakeholders in Question one, and the content of the Minister of Commerce (2011a; 2011b; 2011c) and XRB (2011a; 2011b) documents?'

### **Question Two 2009/2010 submissions vs. 2011 Minister of Commerce/XRB documents**

The documents issued by the Minister of Commerce (2011a; 2011b; 2011c) and XRB (2011a; 2011b) respectively takes over from where the MED (2009) and ASRB (2009) documents left off. The paper outlines further proposals for the accounting standards framework for public benefit and NFP entities as well as addressing some of the issues raised by the ASRB discussion document. Submissions made by members of the public in relation to both the MED (2009) and ASRB (2009)

questions, were identified as having been considered in the process of developing the documents. However, as *Table IX* shows submissions were not always acted on.

**Table IX Comparison of submissions and 2011 documents**

<i>MED (2009) &amp; ASRB (2009)</i>	<i>Minister of Commerce (2011a; 2011b; 2011c) XRB (2011a; 2011b)</i>
<p><b>Basis of Tier splits</b> <i>Majority Agreement:</i> Annual operating expenditure as the basis of tier splits. <i>Concerns:</i> What included in operating expenditure e.g. depreciation &amp; donated volunteer time. Need to average operating expenditure over 3-5 years.</p>	<p><b>Basis of Tier splits</b> Annual operating expenditure as basis of tier splits  Expenses as recorded in the Operating Statement i.e. includes depreciation &amp; volunteer time. <b><u>Not acted on</u></b></p>
<p><b>Size of Tier</b> <i>Majority Disagreement:</i> Using \$10 million, \$1 million and \$20,000. <i>Concerns:</i> \$20,000 should be GST level i.e. \$60,000. Do not have different levels for NFP and Public sector.</p>	<p><b>Size of Tier</b> <i>Changed to:</i> \$30million, \$2million, \$40,000  <b><u>Not acted on</u></b> <i>Acted on</i></p>
<p><b>GAAP</b> <i>Majority Disagreement:</i> Do not agree with using IPSAS as a basis for NFP application but: <i>Agreement:</i> Tier 1 Full PBE standards; Tier 2 Differential; and Tier 3 Simple format reporting</p>	<p><b>GAAP</b> <b><u>Not changed:</u></b> IPSAS as a basis for NFP application. <b><u>Tier 2 changed:</u></b> Tier 1 Full PBE standards; Tier 2 Reduced Disclosure Requirements (RDR); and Tier 3 Simple format reporting</p>

The XRB (2011a; 2011b) as a crown entity must constitutionally follow the lead of the Minister of Commerce's (2011a; 2011b; 2011c). This is specifically seen in regards to the setting tier sizes, where the only rationale given by the XRB is that they have decided to follow the MED proposals simply for the purpose of 'simplicity' (XRB, 2011b, paragraph 31).

The MED through the Minister of Commerce (2011a; 2011b) appear to have disregarded public submissions made in regards to the setting of tier sizes. This was especially the case with regards to the revised tier 3 thresholds proposed in the MED review papers of \$40,000 (Minister of Commerce, 2011a; 2011b; 2011c). Many public submissions presented to the MED argued for the tier 3 lower thresholds to be set at \$60,000 in line with the GST registration requirements. In this circumstance, the MED have clearly marginalised the views of the submitting public, instead opting for a threshold that they have themselves considered to be 'reasonable'. The justification for the size distribution appears to implicitly relate to the registered charities' annual operating expenditure, where: tier 1 reflects 4% of charities; tier 2 reflects 40% of charities; and tier 3 the remaining 55% (Minister of Commerce, 2011b, paragraph 97). This distribution assumes that registered charities will form the bulk of the organisations impacted by this financial reporting policy and this may not necessarily be the case.

Concerns raised by the ASRB submissions regarding the proposed introduction and implementation of IPSAS for PBEs and NFPs were only briefly addressed by the XRB (2011b). Modifications that were needed to be made to actually address specific concerns were not detailed. The IPSASB agenda was further endorsed by the XRB, with little justification as to why they have specifically considered this form of sector specific standards appropriate for the New Zealand NFP sector.

Throughout the course of the XRB (2011b) consultation paper, the XRB could be perceived to have adopted a 'we know best for the future' attitude, especially in regards to the IPSAS issue. However, the situation is not what it seems as the XRB has legitimised their actions in other ways which will be discussed next where legitimacy theory is utilised as the lens through which the actions of the XRB can be explained.

## **DISCUSSION**

First, legitimacy theory is examined to explain the XRB's actions with regards to the views of their stakeholders. Next, stakeholder theory is utilised in explaining the categorisation of stakeholders.

### **Legitimacy Theory**

Legitimacy is best defined by the seminal work of Suchman (1995, page 574):

*"Legitimacy is a generalised perception of assumption that the actions of an entity are ... appropriate within some socially constructed system of norms, values, beliefs, and definitions".*

The typology of organisational legitimacy are pragmatic, moral/normative and cognitive (Suchman, 1995; Durocher, Fortin & Côté, 2007). Durocher and Fortin (2010) explained the typology in relation to standard setting: (1) pragmatic – the assessments stakeholders make; (2) moral – the evaluation of an organisation from the stakeholder's value system; and (3) cognitive – the taken-for-granted activities.

Legitimacy theory requires a 'social contract' between the organisation and the society in which it operates (Guthrie, Petty, Yongvanich & Ricceri, 2004). Social contract is used to represent the multitude of stakeholders' expectations and ensures organisations, such as standard-setters, operate within the norms of the society they operate in.

Baylin et al. (1996) consider that social contract is particularly relevant for standard-setters who must generate support from their stakeholders for their promulgations to be seen as legitimate. They separated legitimacy approaches into: substantive legitimacy which is concerned with the

content of the standard (Richardson, 1985); and procedural legitimacy which looked at the process by which a standard is created (Johnson & Solomons, 1984; Richardson & Dowling, 1986; Deegan & Blomquist, 2006). The study focuses on procedural legitimacy as it considers the standard-setting process that has been undertaken to derive appropriate financial reporting and how standard-setters (in this case the XRB) legitimise their action if their decisions are contrary to those of their stakeholders.

The study utilises the work of Durocher & Fortin (2010) on standard-setting legitimacy management in assessing the 'legitimacy' of the XRB. This is based on Suchman's (1995) legitimacy management strategies of; gaining, maintaining and repairing. Samkin and Schneider (2010) consider that gaining legitimacy is what an organisation does when faced with the task of gaining legitimacy for a new process.

The XRB has had to face the "daunting task of winning acceptance" (Suchman, 1995, p. 586) from their stakeholders since their establishment in July 2011. They have achieved this by conforming to the environment and achieving pragmatic legitimacy through offering decision-making access to their stakeholders. Whilst some of the explanations of decisions made appear arbitrary (XRB, 2011b) these were supported by explicit communication with their stakeholders through; (1) public meetings and (2) working groups.

The public meetings were directed at a range of stakeholders, including the charities sector, preparers of financial reporting, and academics. In the 11 months of its existence their website identified that the XRB have made 19 presentations and 5 podcasts ([www.xrb.govt.nz](http://www.xrb.govt.nz)). In these meetings the XRB justified the reasoning behind their decisions and asked for feedback.

Whilst there is minimum justification on their consultation paper (XRB, 2011b) the XRB (in their old guise as the ASRB) detailed their deliberations on their website (ASRB, 2010c). The ASRB (and later the XRB) considered five issues which affect the charities sector during their Board meetings from March 2010 until the ASRB's disestablishment. Matters needing further consideration were dealt with by a series of stakeholder focused working groups which to date have published the following reports:

- Suitability of IPSAS Review: Report of the Working Group (ASRB, 2010a);
- Suitability of IPSAS for NFP entities: Working Group report (2010b);
- Simple format reporting for NFP entities: Working group report (XRB 2011e).

This is a different approach from that seen by the MED (2011a, 2011b, 2011c) and the Australian Treasury (2011c) who were explicit in justifying why stakeholders' views were not followed. The Australian Treasury (2011c) published a 'final report' that provided a detailed: summary of submissions; issues raised by submitters; and the recommendations that are being proposed. The MED (2011a, 2011b, 2011c) went one step further by providing a summary of consultations and then utilising contemporary research as a rationale for recommendations. However, as previously highlight not all decision were justified.

As standard setting is a social institution, to survive the XRB must maintain its legitimacy or else their standards will be deemed not in the public interest (Baylin et al, 1996). To do this their actions and policies must be justifiable to their stakeholders (Bernstein & Hannah, 2008). The study considers the XRB has done this by proactively searching for input from stakeholders, explaining the XRB's decisions and ensuring stakeholders' preferences are followed and justifying situations of non-responsiveness (Durocher & Fortin, 2010). Thus the XRB has ensured adequate levels of feedback and acceptability is gained by "*reaching out to the full range of stakeholders*" (Christensen & Mohr, 1999, p. 130). To support its reasoning the XRB has chosen to follow the due process adopted by the international bodies, so is perceived to be "doing and right thing" i.e. cognitive legitimacy (Durocher & Fortin, 2010, p. 496).

In a society committed to "*democratic legitimisation of authority, only politically responsive institutions have the right to command others to obey their rules*" (Gerboth, 1973, p. 481). Thus, it is essential that standards are promulgated in an impartial forum in which stakeholders' views are considered (Gerboth, 1987). Johnson and Solomons (1984) identified three conditions essential for standard-setters to maintain legitimacy and regulatory defensibility. First, standard-setters need to have sufficient authority to issue financial reporting standards which is granted to the XRB by section 24(1)(a) Financial Reporting Act 1993, also section 26(1) explicitly requires them to consult with stakeholders before issuing standards. Second, the need for substantive due process this has been addressed by the XRB providing rationale for their decision-making. Third, procedural due process where the XRB has provided several forums for stakeholders to provide input i.e. submissions, presentations and working groups. Next, stakeholder theory is looked at to analyse the categorisation of submitters.

## **Stakeholder theory**

The coding of submissions under a predetermined set of common entity criteria allowed for the analysis of both MED and ASRB submissions by entity type (refer *Table X*). NFPs were categorised as per ICNPO (Refer *Table I*) with public sector organisations split by type and for-profit organisations categorised by the specific industry/activity of which the entity is predominantly a part. This broadly followed Palmer (2011) and allowed for the analysis of submissions according to the nature of the entities from which the submissions were made.

**Table X Categorisation of Submitters**

<i>Categories</i>	<i>MED</i>	<i>ASRB</i>
<b><i>Not for profits</i></b>		
Sport, Recreational and Cultural	1	
Education and research	1	3
Civic and advocacy groups	5	6
Religious congregations and associations	7	5
Unions, business and professional associations	1	1
<b><i>Professions and individuals</i></b>		
Tangata Whenua-based organisations	1	1
Independent individuals including academics	5	5
Professional Services: Accounting and Law	10	6
<b><i>For profits</i></b>		
Engineering	3	
Retail	2	1
<b><i>Public sector</i></b>		
Government departments		2
Independent crown entities	3	3
Local body government	1	2
State owned enterprises		2
<b><i>Total submitters</i></b>	<b><i>40</i></b>	<b><i>37</i></b>

#### **COLLECTIVE ACTION OF STAKEHOLDERS**

Through undertaking an examination of the differing classifications of entities submitting, it was possible to evidence patterns occurring in the submission responses between separate entities in the same content analysis classification. Similarities were particularly evidenced between those entities whom came under the ‘Religious Congregations’ classification. This was especially the case when considering the entirety of submissions made by the Presbyterian Church of New Zealand (MED 53 & ASRB 26), the Catholic Diocese of Auckland (MED 50 & ASRB 30), the NZ Catholic Bishops’ Conference (ASRB 29) and the Roman Catholic Church of New Zealand (MED 55). It should be noted that these entities are representative of two specific religious organisations the Presbyterian Church and Roman Catholic Church respectively, from the desks of members of these organisations. Further submissions from other entities classified under ‘Religious Congregations’ were not evidenced to have collaborated with any of the entities listed above, presenting

seemingly 'independent' submissions. Such is the case with Presbyterian Support (MED 76 & ASRB 20), a religious-based social service provider connected with the Presbyterian Church.

Data released by the Charities Commission (2011) highlights a possible motive of the 'Religious Congregations' sector to cooperate towards the advancement of a mutual agenda, particularly in regards to what financial information the 'Religious Congregations' would be required to disclose. Seven out of the ten largest registered group charities of total income and asset value and six of the seven top donations were classified under 'Religious Congregations'. The largest charity group was the Roman Catholic Diocese of Auckland Group, which had total income and assets of NZ \$793,110,000.

A 'strength in numbers' approach when considering the purpose of the submissions i.e. to allow stakeholders to voice concerns over issues discussed in each respective discussion document may therefore act to reinforce and bring greater attention to significant issues which certain members within a specific NFP classification have. This supports Durocher, et al (2007, p. 31) who considered "*consensus is necessary to encourage collective action, and is possible in smaller groups that cost less to organise*". This appears to be the case with 'Religious Congregations. Next who are the 'legitimate' stakeholders are considered.

#### *LEGITIMATE STAKEHOLDERS*

Mitchell, Agle & Wood (1997, p. 855) consider that stakeholder theory attempts to determine "*which groups are stakeholders deserving ... attention, and which are not*". Literature recognised key standard-setting stakeholders as: resource providers, accounting firms, academics, government departments and the general public (Lee, 2004; Woodward & Marshall, 2004; Cooper & Robson, 2006; Durocher, Fortin & Côté, 2007; IPSASB, 2010; Hanson, 2011; Hyndman & McMahon, 2011; Palmer, 2011; Larson, Herz & Kenny, 2011). All these 'legitimate' stakeholders, apart from the general public, made submissions. However, it is questionable as to whether the for-profit submissions (refer *Table X*) could be deemed the general public and meet Donaldson and Preston's (1995) definition of legitimate stakeholders.

Palmer (2011) included funders as key stakeholders so of particular surprise was the lack of any submission from the Fundraising Institute of New Zealand. A study by Tandy and Wilburn (1992) considered that stakeholders will participate if they consider there is a benefit in doing so. So it was disappointing that the Fundraising Institute of New Zealand made no submission given that funders were key stakeholders of the sector (Christensen & Mohr, 2003; Palmer, 2011).

Larson et al (2011) consider that academics are key standard-setter stakeholders so it was disappointing that only five submissions were received from academics for the MED and ASRB either individually (2) or under their university (3) (Larson et al, 2011). The XRB has attempted to find the academic voice by offering to present to academics at all the NZ universities (personal email).

Hyndman and McMahon (2011) considered 'government' a definitive stakeholder i.e. a stakeholder who exhibits power, legitimacy and urgency (Mitchell, Agle & Wood, 1997). Thus it is important that government's views are considered in this study were 10% MED and 24% ASRB submissions were from entities from the public sector (Refer *Table X*).

However, what was disappointing were the lack of detailed submissions from the charities sector umbrella bodies which were labelled 'Civic and advocacy groups' under the ICNPO categories or independent crown entity for the Charities Commission. Only two of these key stakeholders made detailed submissions: Association of Non-Government Organisations of Aotearoa (MED 66 & ASRB 46) and the NZ Federation of Voluntary Welfare Organisation (MED 70 & ASRB 67). Several made generalised comments rather than directly answering the specific questions (*Appendix One & Appendix Two*) these included: Charities Commission (MED 141 & ASRB 75), Volunteering New Zealand (MED 100 & ASRB 53) and Philanthropy New Zealand (MED 36 & ASRB 25).

As the previous section highlights an apparent lack of listening by accounting regulators to their charitable stakeholders, this section utilised legitimacy and stakeholder theories as the theoretical lens through which the actions (or inactions) of the XRB could be viewed. Through these lenses the XRB could be seen to proactively seek to gain legitimacy in the eyes of their charitable stakeholders.

## **CONCLUSION**

This study set out to investigate how accounting standard setters and regulators derived appropriate financial reporting standards, and to what extent these stakeholders are involved in devising standards on accounting reporting and regulation. NVivo was utilised to search, organise and track submissions from the MED (2009) and ASRB (2009) discussion papers. In this way the attitudes of charitable entities and their stakeholders to proposed changes of financial reporting requirements could be determined.

This empirical evidence was critically analysed with the proposed financial reporting framework issued by the Minister of Commerce (2011a, 2011b, 2011c) and XRB (2011a, 2011b). To assess whether accounting regulators listen to their charitable stakeholders.

Critical comparison of submissions and proposals appear to initially show that the XRB was not listening to their charitable stakeholders. However, stakeholder theory and legitimacy theory were utilised as the theoretical lens through which the XRB's action was viewed. The study found that the XRB utilised legitimacy management strategies to explain their proposals. They proactively achieved this by conforming to the environment and achieving pragmatic legitimacy in order to justify their decisions.

The study will also be of interest to a wider audience as it seeks to determine whether accounting standard setters and regulators are listening to their stakeholders something of interest to accounting standard setters and regulators in both the for-profit and public sectors.

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## Appendix One – Ministry of Economic Development questions

[http://www.med.govt.nz/templates/MultipageDocumentPage\\_42001.aspx](http://www.med.govt.nz/templates/MultipageDocumentPage_42001.aspx)

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### The application of the indicators to private non-profit entities (Part 7)

Q15 What comments do you have on the proposal to use annual operating expenditure as the means for determining whether a private non-profit entity is small, medium or large?

Q16 What comments do you have on the proposals to use annual operating expenditure of \$20,000 and \$20 million as the cut off points between small and medium, and medium and large respectively? If you consider that other criteria should be used, what are those criteria and what cut-off points should be used?

## Appendix Two – Accounting Standards Review Board questions

[http://www.asrb.co.nz/Site/Financial\\_Reporting/Discussion\\_Document.aspx](http://www.asrb.co.nz/Site/Financial_Reporting/Discussion_Document.aspx)

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### ***Proposed Accounting Standards Framework: Public Benefit Entities***

Q8 Do you agree that entity size (based on expenditure but not asset value), and in the case of public sector entities also the nature of the accountability relationship, should be used to allocate entities to the PBE sector tiers? If not, what alternative would you suggest and why?

Q9 Do you agree that for the PBE Sector Tier 1 should comprise entities with expenditure  $\geq$ \$20 million (public sector) or  $\geq$ \$10 million (not-for-profit sector) plus entities that are leviers of coercive revenue (regardless of size)? If not, what alternatives would you suggest and why?

Q10 Do you agree that Tier 3 should comprise entities with expenditure under \$2 million (public sector) or under \$1 million (not-for-profit sector)? If not, what alternative would you suggest and why?

Q11 Do you agree that: (a) a set of NZ PBE Accounting Standards should be developed for use by PBEs; (b) as part of this IPSAS be used as the basis for reporting in the public sector; and (c) a NFP Application (building on IPSAS) be used as the basis for reporting in the not-for-profit sector? If not, what alternative would you suggest and why?

Q12 Do you agree that: (a) the full PBE standards should apply to Tier 1; and (b) a differential version of the PBE standards should apply to Tier 2 in the PBE sectors? If not, what alternative would you suggest and why?

Q13 Do you agree that 'Simple Format Reporting' should apply to Tier 3 entities in the PBE sectors? If not, what alternative would you suggest and why?

## Appendix Three –Categorisation of Submission by NFPs & stakeholders

<i><b>MED</b></i>	<i><b>Submittee Categorisation</b></i>	<i><b>15</b></i>	<i><b>16</b></i>
4	Civic and advocacy groups	✓	✓
6	Independent crown entities	✓	✓
9	Independent Individuals	✓	✓
14	Professional Services: Accounting	✓	✓
18	For profit entity: engineering/agriculture	✓	✓
27	Sport, Recreational and Cultural	✓	✓
28	For profit entity: retail	✓	✓
40	For profit entity: manufacturing/engineering	✓	✓
43	Professional Services: Legal	✗	✓
44	Independent Individuals	✓	✓
47	Religious Congregations	✓	✓
48	Independent Individuals	✓	✓
49	For profit entity: construction/engineering	✓	✓
50	Religious Congregations	✓	✓
52	Professional Services: Accounting	✓	✓
53	Religious Congregations	✓	✓
54	Tangata Whenua-based Organisations	✓	✓
55	Religious Congregations	✓	✓
60	Civic and advocacy groups	✓	✓
66	Civic and advocacy groups	✓	✓
68	Civic and advocacy groups	✗	✓
69	Professional Services: Accounting	✓	✓
70	Civic and advocacy groups	✓	✓
73	Non-profit service providers: Education, Research	✗	✓
75	For profit entity: retail	✓	✓
76	Religious Congregations	✓	✓
81	Religious Congregations	✓	✓
85	Independent crown entities	✓	✓
86	Professional Services: Accounting	✓	✓
97	Professional Services: Accounting	✓	✓
104	Professional Services: Accounting	✓	✓
108	Professional Services: Accounting	✓	✓
124	Independent Individuals	✓	✓
129	Unions, business and professional associations	✓	✓
138	Religious Congregations	✓	✗
140	Professional Services: Accounting	✓	✓
142	Independent Individuals	✓	✓
147	Professional Services: Accounting	✓	✓
148	Independent crown entities	✓	✓
149	Local body government	✓	✓

<b>ASRB</b>	<b>Submittee Categorisation</b>	<b>8</b>	<b>9</b>	<b>10</b>	<b>11</b>	<b>12</b>	<b>13</b>
2	Civic and advocacy groups	✓	✓	✓	✓	✓	✓
3	Independent crown entities	✓	✓	✗	✓	✓	✗
4	Non-profit service providers: Education, Research	✓	✓	✓	✓	✓	✓
7	Professional Services: Legal	✓	✓	✓	✓	✓	✓
8	Independent Individuals	✓	✓	✓	✓	✓	✓
10	Religious Congregations	✓	✓	✓	✓	✓	✓
11	Non-profit service providers: Education, Research	✓	✓	✓	✓	✓	✓
16	Non-profit service providers: Education, Research	✓	✓	✓	✓	✓	✓
18	State owned enterprises	✗	✗	✗	✓	✗	✗
20	Religious Congregations	✓	✓	✓	✓	✓	✗
21	Local body government	✗	✗	✗	✓	✓	✗
26	Religious Congregations	✓	✓	✓	✓	✓	✓
27	Tangata Whenua-based organisations	✓	✓	✓	✓	✗	✗
28	Civic and advocacy groups	✓	✓	✓	✓	✓	✓
29	Religious Congregations	✓	✓	✓	✓	✓	✓
30	Religious Congregations	✓	✓	✓	✓	✓	✓
31	Professional Services: Accounting	✓	✓	✓	✓	✓	✓
34	Independent crown entities	✓	✓	✓	✓	✓	✓
37	Independent Individuals	✓	✓	✓	✓	✓	✓
38	Independent Individuals	✓	✓	✓	✓	✓	✗
41	Civic and advocacy groups	✓	✓	✓	✓	✓	✓
45	Independent Individuals	✓	✓	✓	✓	✓	✓
46	Civic and advocacy groups	✓	✓	✓	✓	✓	✓
48	Civic and advocacy groups	✓	✓	✓	✓	✓	✓
50	Professional Services: Accounting	✓	✓	✓	✓	✓	✓
52	Professional Services: Accounting	✓	✓	✓	✓	✓	✓
54	Governmental departments	✓	✓	✓	✓	✓	✓
55	For profit entity: retail	✓	✓	✓	✓	✓	✓
57	Professional Services: Accounting	✓	✓	✓	✓	✓	✓
63	Governmental departments	✗	✗	✓	✓	✓	✓
64	State owned enterprises	✗	✗	✗	✓	✗	✗
66	Independent crown entities	✓	✓	✓	✓	✓	✓
67	Civic and advocacy groups	✓	✓	✓	✓	✓	✓
69	Independent Individuals	✓	✓	✓	✓	✓	✓
70	Professional Services: Accounting	✓	✓	✓	✓	✓	✓
73	Unions, business and professional associations	✓	✓	✓	✓	✓	✓
74	Local body government	✓	✓	✓	✓	✓	✓