

Charity Reporting on Accumulated Funds

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Putting Wealth to Work for Generations

| New requirement of charities to further report on accumulated funds

Key takeaways

- Many charities will need to further report on the reason that they are holding reserves, under new changes to charities legislation and associated reporting. This will be through an enhanced Annual Return submitted to Charities Services.
- Consultation on the new Annual Return form closed in November 2023, and Charities Services expects the final form to be released in mid-2024.
- We would encourage charities to further review their reserves policy, or if in absence of such a policy, to create one, to assist in articulating the rationale for accumulating and holding funds in reserve.
- The case for charities to accumulate funds to maintain financial stability, and to support delivery of their charitable purpose over the long term is well documented.
- The changes proposed do not extend to a mandatory distribution requirement (as is already required of certain kinds of charities in Australia and Canada).

Context and proposed changes for additional reporting on accumulated funds

An additional change that comes from the review of the Charities Act 2005, but was not included in the Charities Amendment Act 2023,² involves increasing the transparency on accumulated funds held by all but the smaller charities.

This will require charities with annual operating expenses over \$140,000 to declare and explain any accumulated funds – whether in the form of cash, assets or other resources. This additional reporting will capture all charities in the Tiers 1, 2, and 3 reporting categories that together represent over 96% of total assets in the sector, and 42% of all charities.

The new proposed reporting changes do no more than seek further transparency from charities about the purpose of accumulations. The mechanism is a non-legislative change that involves Charities Services merely updating its Annual Return form.

¹ An update to Client Briefing Note, 15 June 2022

² Following a review of the Charities Act 2005, the Charities Amendment Act 2023 was enacted in July 2023 and amends various aspects of the charity registration and reporting requirements under the Act. Most changes in this Amendment came into effect on 5 October 2023, but some relating to the processes for objections and appeals do not come into force until 5 July 2024.

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The consultation by Charities Services on the proposed changes to the Annual Return forms has now closed and whilst the new forms have yet to be released, the additional question in the draft form for charities in the Tiers 1, 2, and 3 reporting categories was put as follows:

- *How do you plan to use your charity's accumulated funds in the future?*

Things to consider: How accumulating funds will help to achieve your charity's goals of advancing your charitable purpose. Specific reasons for accumulating funds (i.e., planning for future generations and the sustainability of your charity or upcoming significant projects or planned capital expenditure (e.g., buildings))

Charities Services expects to have the new Annual Return forms ready for use by the middle of 2024.

This may prompt many charities to further articulate the reasons why they are accumulating funds and may require charities to further review their reserves policy, or if in absence of such a policy, create one. This will assist in stakeholders looking behind a headline number and understanding the organisation's rationale for accumulating funds.

Does New Zealand need additional reporting on accumulated funds?

Whether this non-legislative change to provide further disclosure is necessary remains uncertain. New Zealand already has some of the most comprehensive financial transparency and accountability rules for charities.

An explanation of reserves by way of separately itemised allocations is already a convention in the reporting frameworks of larger charities that represent most of the sector's accumulated funds. For example, the reporting of an operating contingency reserve, asset revaluations / replacement reserves, special projects reserves, and so on.

The Regulatory Impact Statement issued by government on the matter of accumulation of funds stated that there is a "lack of strong quantitative evidence and data to support the work" and there is a "variable" quality of problem statements "in some cases making it hard to see how the recommended options would impact the identified problem."³

We remain unsure whether this is a solution in search of a problem. Similar jurisdictions like Australia, the United Kingdom, and Canada do not request information on why accumulated funds are held in their annual returns. The rationale for government to make this voluntary reporting requirement mandatory is, it would seem, to get sector level data about the level of accumulation to inform compliance and possibly guide next steps in charity policy development.

One recent commentator has suggested this proposed reporting change may be pandering to a view that the accumulation of reserves is wrong, in so far that it is somehow inconsistent with charitable purpose and public benefit.⁴

This is not a view shared many funders, although it remains to be seen what is the position of our new government.

The distinction needs to be made between, on the one hand, providing an explanation in the financial statements and annual returns of the purposes of reserves held and, on the other, providing a mandatory distribution requirement (as is already required of certain kinds of charities in Australia and Canada).

Note, the proposed changes do not extend to any mandatory distribution. We would hold that whether any funds received should be expended or reserved is a decision that is best made by the governing body of a charity, given the myriad of circumstances that need to be taken into account.

³ Sue Barker, Director of Charities Law, in referencing Department of Internal Affairs Regulatory Impact Statement: Modernising the Charities Act (Report, 19 October 2021)

⁴ John Godfrey, Philanthropy and Fundraising Consultant

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Stating the case for accumulating funds in reserves, and new Annual Return form

The fragility of many charities during the disruptive Covid years has been well reported (refer CSI Time to Shine COVID-19 Impact Community Survey Report 2020, and JBWere Cause Report 2021). For many not-for-profit social service providers there was already a funding gap, prior to Covid impacts and the cost-of-living crisis that have heightened demand for their services, between what they were funded to deliver and the real delivery cost (\$630m per year, Martin Jenkins 2019).

In addition, the economic turbulence expected in 2024–25 still requires charities to prudently conserve their cash and assets. A charity can make a strong case for accumulating funds and building reserves to ensure it can endure and fulfil its mission over the medium-long term. At the same time, many large charities need to maintain high value assets to carry out their charitable purpose, such as universities, research institutes, social services organisations, and health care providers.

To recap, accumulation of funds and the work of charities to build up their reserves is not contrary to charitable purposes as, by definition, all funds of a charity must ultimately serve a charitable purpose, not private profit.

Accumulating cash, assets and other resources is necessary for charities to grow and remain sustainable to deliver on their charitable purpose. Charities typically operate over a medium-long term horizon and need financial certainty to operate and to ensure funding is available to provide grants and services in response to community need.

Accumulation of funds can represent good governance practice by a charity for:

- Increasing investment funds to generate future income for charitable expenditures or distributions;
- Reserving funds to cover operational costs during temporary income losses, ensuring stability for both staff and beneficiaries;
- Supporting long-term expenditure plans, such as constructing new buildings, undertaking capital projects, or to expand operations;
- Establishing stable alternative sources of income to counter fluctuations in revenue from fundraising, grants, and contracts;
- Growing funds to sustain perpetual distributions for the benefit of the community, particularly for charities managing endowment funds like those held by community and other public foundations;
- Effectively managing iwi assets for the well-being of current and future generations.

Clearly, accumulating funds can enable charities to achieve better longer-term outcomes, as a function of investing in people, assets, innovation, and growth. Moreover, the aggregation of reserves set aside as investment funds leads to financial stability and sustainability of charities by reducing their reliance on donations and government funding.

The practice, with appropriate reporting requirements, should be encouraged.

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A mission aligned reserves policy will aid in supporting the additional reporting

A well drafted reserves policy setting out financial reserve requirements, along with links to the investment policies, will be most defensible against external stakeholders when it is linked to sustaining the long-term mission and sought impact of the organisation. Particularly, where the policy considers the longevity of the charity in supporting future generations and providing the buffer to support its operations and/or granting commitments in the event of unexpected circumstances.

For additional insight, we refer you to the following links:

- [Changes to the Charities Act: What you need to know](#) Booklet by Sue Barker, 2023
- [Not-for-profit cash reserves](#) An ANZ Chartered Accountants whitepaper, 2020
- [A guide to creating a plain English NFP reserves policy](#) Grant Thornton, 2021
- [Regulator fiddles while charities burn](#) Opinion by Centre for Not for Profit Governance and Leadership
- [Charities Act changes – helpful or hurtful? | BusinessDesk](#) Opinion piece by Craig Fisher, Consultant at RSM. Current for-purpose governance roles include Chair of External Reporting Board's Advisory Panel, and Chair of Fred Hollows Foundation

"The fact that charities receive tax privileges does not convert their funds into government funds, or require them to forfeit control over day-to-day operational decision-making: a decision to accumulate funds may in fact be the best way for a charity to pursue its charitable purposes in particular circumstances, just as accumulating funds may at times be in the best interests of a private company... The fact that all registered charities are, by definition, subject to the non-distribution constraint and the destination of funds test: all funds of a charity must, by definition, ultimately be destined for charitable purposes. A charity cannot breach this requirement lawfully"

– Sue Barker. Charities Law Reform, Aotearoa New Zealand

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