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Charity financial reporting regulation: a comparative study of the UK and New Zealand

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Abstract
Charities are becoming more highly regulated worldwide and yet they are subject to diverse, country-specific, financial reporting standards. New Zealand is a jurisdiction that has treated all sectors alike in its approach to the financial regulation of charities, while the UK has, for some time, separated the regulation of charities from other entities. This article provides a comparison of the histories of the evolution of regulation for charity reporting in the UK and New Zealand. The current process of international harmonization in both jurisdictions is premised on the principle that accounting conceptual frameworks should not be jurisdiction-specific, but charities have proved to be an exception. We suggest in this study that this exception is attributed to different drivers resulting in regulatory distinctions in two otherwise similar jurisdictions. Without persisting in the maintenance of sector-neutrality, the inevitable divergence increases the load on preparers, attesters, and users and may lead to lower levels of accountability and transparency.

Keywords: *Charity regulation; financial reporting; New Zealand; UK*

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1. Introduction

The rise of charities as an economic force in today's society is well documented (e.g. Salamon & Anheier, 1997). Yet, unlike profit-oriented entities subject to securities market regulation and required to produce financial reports compliant with International Financial Reporting Standards (IFRSs), most industrialized countries impose minimal charity regulation and operate "under-developed" financial reporting standards (Wilke, 2003). This article considers the issue of financial reporting regulation for charities, comparing the evolving history of charity reporting regulation in the UK and its former colony, New Zealand. While the UK separates out the regulation of charities from all other entities, thus erecting a protective barrier for the sector, New Zealand has taken a sector-neutral or charities included approach to its regulation of financial reporting. The process of harmonization in both these jurisdictions through the adoption of IFRSs is more than meeting the needs of multinational enterprises: the current moves to IFRSs are premised on the principle that accounting conceptual frameworks should not be jurisdiction-specific. So why and how have charities proved the exception to this rule? We suggest in this study that it is attributed to different drivers resulting in regulatory distinctions in two otherwise similar jurisdictions.

Both the UK and New Zealand are common law countries where evolving case law redefines how the community understands 'charity' over time (Salamon & Anheier, 1997). In order to provide an understanding of the historical events, which resulted in the establishment of charity regulators in the UK and New Zealand, this article first describes the charity sector, and then reviews the history of sector-specific regulations. The relationship between the state and the charity sector will undoubtedly affect the regulatory regime in existence (Tennant, 2001); therefore a historical perspective on the regulation of charities in the UK and New Zealand will facilitate comparing and contrasting evolutionary regulatory outcomes. Finally, the core differences will be linked to some drivers underlying charity regulation.

2. The charity sector

2.1. The composition of the charity sector

Charities exist in virtually all societies, but internationally the characteristics and relative independence of such non-governmental agencies depends on the historical and socio-political context (Kramer, 1990). For an organization to be a charity, its purposes must be exclusively charitable (Connolly & Hyndman, 2000). The Statute of Charitable Uses (1601),[1] "formed the cornerstone of the legal definition of charitable purposes" (Brown, 2002, p.72). Although the 1601 law was repealed in 1888 in the UK[2] and had no counterpart in New Zealand, its spirit has continued in case law. In 1891, Lord MacNaughton classified charitable purposes under four

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heads (in the Pemsel case, [1891] AC 531) as: the relief of poverty; the advancement of education; the advancement of religion; and, other purposes beneficial to the community. Several Commonwealth initiatives have reviewed the definition of charitable purpose, with the UK's Charities Bill foreshadowing a more detailed description of charitable purpose in that country by listing 10 separate defining categories. Modern codification has variously been seen as both risking the flexibility of case law,[3] and as a desire that public benefit ("purposes beneficial to the community") may be more clearly defined (Gousmett, 2003).

Such a broad definition of charitable purposes encompasses diverse organizations that also span many legal entity types. Charities are involved in activities of common concern to members and donors, but which typically are beneficial to people beyond that membership (Saxon-Harold, 1990). Hayes (1996) reviews many different categories of charities devised by scholars describing a functional typology, while Manley (1988) prefers a focus on entity funding. Typologies have been largely unsuccessful in providing discrete sectoral groups and an alternative representation of this sector is provided by data from the UK, where in 2005 over 167,000 charities received total income of £37 billion generated from government grants and contracts, and the general public (approximately 37% each) with the remainder from other sources. However, the majority of charities had less than £10,000 in income, with 13,000 charities accounting for 90 per cent of the total sector's income and a mere 551 charities recording 46 per cent of total charity income (Charity Commission, 2005b). New Zealand's current statistics (estimates of between 17,000 and 35,000 charities) do not assist further in defining this sector, which is a subset of the not-for-profit sector at large.

Many charities are also "trusts". Trust is a more complex word used in law and commerce as well as daily life. Seal and Vincent-Jones (1997) suggest a lack of consensus on what trust actually is, but note it generally points to a fiduciary duty, or responsibility to act in the best interests of a "vulnerable other", when managing their property or possessions. While any misuse of charity donations is inexcusable, experience in the UK as well as New Zealand suggest malfeasance has historically occurred only at very low levels (Hayes, 1996).

Accordingly, this article considers the last 40 years of interest in this sector's financial regulatory systems, as it has evidenced the strengthening of the UK charity monitoring and regulatory structure. The announcement and emergence of charity-specific regulation in New Zealand provides an opportunity to compare and contrast these events in order to assess the strengths and weaknesses of disparate systems.

2.2. Charity regulation

Because charitable entities are diverse in size and entity type, this presents challenges to regulators who seek increased transparency and accountability in charitable

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institutions. High quality financial reporting is one aim of charity monitoring, with financial reporting regulation or guidelines required by both users and preparers. Unreciprocated contributions by donors result in unreciprocated outflows to beneficiaries and high information asymmetry (Falk, 1992), therefore, charity financial report users will include donors, funders and beneficiaries, with many considering that increased donor information flows provide increased confidence in the sector (Philanthropy New Zealand, 2003; Wilke, 2003). Further, agency theory suggests a need for financial reporting for contractual purposes. Regulation is preferred in order to set minimum standards, to increase the amount of information publicly available and to enhance comparability across entities (Wolk *et al.*, 1992).

Preparers also prefer regulation, evidenced by the charity sector in the UK calling for increased comparability to assist users of financial reports (Charity Finance Directors Group, 2003). Although no single set of accounting rules can best represent the activities of a group of heterogeneous organizations (Parsons, 2003), preparers need to be accountable to users to increase charity legitimacy and reduce risks of sanction, although this article does not address issues relating to charity demise.

Historically, charity self-regulation with regards to financial reporting has achieved only mixed success. In the Netherlands, over half of the known active charities (comprising over 90 per cent of the fundraising market) within a relatively small charity sector, have gained accreditation to the Centraal Bureau Fondsenwerving, and voluntary registration has generated improved financial reporting and governance (Bekkers, 2002). In contrast, a recent report from one US based voluntary agency, the Evangelical Council for Financial Accountability, found members' accounts showed inconsistencies and improprieties, suggesting a lack of standardized reporting and ineffective auditing procedures (Harper & Harper, 1988). Despite the success of self-regulation in some jurisdictions, most require legislative support to ensure standards compliance (Godfrey *et al.*, 2003).

However, the nature of financial reporting regulation formulation is a political activity and has economic consequences. Ensuring compliance demands some convergence of interests between the regulatory body and the regulated group, while balancing other stakeholders' needs. Regulation is inevitably evolutionary, with a political dimension, but change occurs only when the costs of those changes are adequately balanced by the expected economic benefits (Brown, 1990). Full quantification of those costs is impossible, due to the inability to measure the economic benefit of the decision-usefulness of increased information. Further, technical and conceptual considerations are as important as the economic consequences of regulation and the provision of accounting information. It would appear user needs for comparable high quality information must be balanced against preparers' need for certainty and the cost of information provision.

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Mindful of the size and entity diversity in charitable organizations, which will affect these costs, the following sections will review the evolutionary process surrounding the regulation of charity financial reporting. The research focuses on the UK since the 1960 Charities Act, but specifically the events since the 1981 Bird and Morgan-Jones report, and New Zealand, a former British colony and country included in 'Anglo' financial reporting models.

3. Charity regulation in the UK

Crosby suggests that, in the UK, "the history of charity giving and charity legislation is very long, but also very complicated and confusing" (cited in Alvey, 1995, p.4). State intervention into traditional charity areas such as education began in the late nineteenth century and continued with the *National Insurance Act* 1911. The post-Second World War Labour Government brought wide-ranging social legislation reducing the need for charitable support, with the Nathan Committee describing past charitable efforts as "one of the magnificent failures of our history" (Nathan Report, 1952, cited in Alvey, 1995).

However, the 1960s political movements nurtured a new breed of charity, more politically driven. Further, the development of communal, "bottom-up" rather than paternal "top-down" support for beneficiaries depicted another permutation in new classes of charity (Alvey, 1995). Since the 1980s, charity growth has included the rise of corporate sponsorship, professional fundraisers, image consultants and, since 1987, payroll giving; all seeking donor legitimacy. In addition there was rapid funding growth from government grants and contracts, as again charities were called to deliver social aims. There were increases in charities' government fee income of 55 per cent and government grants of 20 per cent between 1991 and 1994 (National Council for Voluntary Organisations [NCVO], 1999). Government funding has continued to increase at a few percentage points a year so that overall, there has been a 40 per cent increase in income to charities from government in the 10 years from 1991 to 2001 (NCVO, 2002).

Considerable growth in charity activity, competition for income sources and the need to provide legitimacy for potential donors, funders and beneficiaries has intensified the need for constructive financial reporting regulation.

3.1. The charity commission

Although the legal system has regulated charitable trusts for hundreds of years, mismanagement and inefficiencies evidenced many regulating Acts, such as the 1601 *Statute of Charitable Uses*. Redress through the courts was, however, "more tardy, costly and frustrating than acting through the Elizabethan Commissions" (Alvey, 1995, p.29, 30) and, despite initial suspicion of government interference, Charity Commissioners were established in 1853. However, it was only with the advent of the

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Charities (Statement of Account) Regulations 1960 (SI 1960 No. 2425) that charities were required to keep proper books of account, prepare financial reporting consisting of an income and expenditure account as well as a balance sheet, and keep those records for at least seven years (Chitty and Morgan, 2001). No audit or independent review was required, and accounts were not required to show a true and fair view. Additionally, charities controlled by other Acts and very small charities were exempted from filing their financial accounts with the Commission. It is understood that the Commissioners reviewed financial reports of some 6–10 per cent of registered charities each year, but this activity was hampered by lack of Commission resources (Bird & Morgan-Jones, 1981).

The accounting profession was also concerned about financial reporting. In 1981, under the auspices of the Institute of Chartered Accountants of England and Wales, Bird and Morgan-Jones completed a major survey of charity reporting finding widespread non-compliance and huge diversity in charity financial reporting. This seminal study spurred discussion of financial reporting issues, being instrumental in the release in 1984 of an Accounting Standards Committee (ASC) Discussion Paper on the issue focused directly on financial reporting issues.[4] Critics called for a more holistic view to encompass non-financial reporting and provide full accountability (Gray, 1984). Chilvers (1987) also expressed concern about the piecemeal framework, although these concerns were resolved partially in ED 38: "Accounting by Charities–Exposure Draft [of a] proposed statement of recommended practice", released after the Discussion Paper. Unfortunately, ED 38 continued to allow diverse reporting practices without stating preferred accounting policies, thus jeopardizing comparability. Due to the voluntary nature of reporting, and, most significantly, a lack of "ownership" by the sector at large, ED 38 was "virtually unknown to the majority of charities" (Chilvers, 1987, p.30) evidencing the difficulties of non-participative regulation.

3.2. Financial reporting regulation for charities

Despite this, the ASC received over 700 pages of submissions on ED38, before producing a draft *Statement of Recommended Practice* (SORP2) in early 1988. The SORP recommended charities produce an annual report that included a trustees' report to explain the objectives, achievements, and aims of their particular charity, thus giving more emphasis to non-financial reporting. The other goal was to improve financial reporting in order that charity reports would be consistent with the extant Statements of Standard Accounting Practice (SSAPs), thus enabling the comparability deemed necessary for accountability to commercial entities covered by the ASC framework. In order to reduce non-compliance, special effort was expended to make SORP2 "readable and intelligible to the non-accountant" (Falk, 1987, p.77). Accordingly the SORP became the benchmark against which charity reporting could be evaluated (Manley, 1988), but again, as it was only a *Statement*

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of Recommended Practice, compliance depended on quality charity staff, a strong regulatory body, and user feedback. Studies such as Williams and Palmer (1998) found charities either ignorant of SORP2 or resistant to change, and Palmer and Vinten (1998) found very few audit qualifications, even when SORP2 had not been followed, thus emphasizing a lack of commitment to the SORP by the sector and the profession. Moreover, the shift to acknowledge the charitable sector from a body charged largely with developing standards for listed companies, created a contradiction requiring resolution.

Concurrent with ASC activity was a National Audit Office review of the Charity Commission, and also Sir Philip Woodfield's 1987 review of the wider issues of efficiency and scrutiny of charities (Connolly & Hyndman, 2000). Both ensuing reports highlighted charity accounts as a key weakness in meeting fundamental stakeholder requirements for accountability. Few charities submitted accounts to the Charity Commission, even fewer were reviewed by that regulatory body, and a very limited number of charity accounts were professionally audited. Vociferous criticism of the Charity Commission was unhelpful for the sector and it was widely reported that the Commission was "so short of funds that it cannot afford to pay the postage to send out reminders to all registered charities" (Irvine, 1988, p.92).

The combination of the alarm generated by these reports, the accounting profession's unease about charity reporting performance and a conviction that good financial reporting was essential for supervision and accountability of charities, led to a revised *Charities Act* (1993) (Chitty & Morgan, 2001). The requirements of the 1960 Act to keep proper accounting records remained, but it became mandatory for registered charities to lodge financial accounts with the Commission within 10 months of year-end (s. 45).[5] Furthermore, all accounts were required to be audited; or examined by a suitably qualified independent person if the charity was small (with an income or expenditure under £10,000 a year).

The accounting profession itself was undergoing change, and when the Dearing Report created a new Accounting Standards Board (ASB) in 1990 that body decided not to adopt SORPs but to leave them to appropriate bodies to continue to develop. Although compliance with Statements of Recommended Practice may not be mandatory (unless required by sector-specific legislation) research has shown that where a representative body develops a SORP, compliance is more likely to occur.[6] The decision not to adopt previously published SORPs was apparently driven by the Dearing Report's call for increased quality in financial reporting, along with the acknowledgement that the ASB's task was to issue Financial Reporting Standards for general purpose financial statements compliant with their Framework. SORPs provide supplementary guidance on applying accounting standards to specialized transactions in industries or sectors and must comply with the ASB's code (ASB, 2000) but may have departures from Standards on issue. Subsequently the profession

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worked with the Charity Commission to update SORP2, with the ASB granting it "negative assurance"[7] in 1995 (Palmer & Vinten, 1998) and it was issued for use with effect from 1 March 1996.

Although this move to financial regulation by a body other than the profession reduced the influence of the profession on charities, a single SORP provided a complete body of knowledge for those providing professional services to the sector, amid a desire for increased compliance, and higher quality audits (Palmer & Vinten, 1988). The extra costs of producing a SORP under a specific regulatory body were seen to be offset by increased transparency and accountability, leading to a deeper donation base.

It was disappointing that subsequent studies found only a minority of charities had adopted the new practices (Connolly & Hyndman, 2000). However, charities with an annual income over £250,000[8] faced mandatory SORP compliance and, as these charities controlled much of the sector's resources, preparers' concern brought increased input to the regulatory process (Palmer *et al.*, 2001). This resonates with the life cycle theory of regulation as espoused by Wolk *et al.*, (1992) in that charities as regulated parties increased their political activity in order to promote their own self-interest and to encourage convergence between the regulator (the Charity Commission) and the regulated. While policy makers may be interested in statistics produced by the Charities Commission, there is no evidence to suggest they were active in the financial reporting standards role.

The new SORP failed to mention the SSAPs on issue at the time and "adopted a radical approach by recognising that charity accounting issues are fundamentally different from those in the commercial sector" (Palmer & Vinten, 1998, p.347). This suggests that a consensus had been reached on a different construction of accountability in the charity sector compared with other entities in the private or public sectors. Further, although the Financial Reporting Standard for Smaller Entities (FRSSE) issued in 1997 also included conceptual concessions, its programme of modified standards for smaller entities was optional, compared to the SORP's mandatory charity accountability framework.

A consequence of the departure from a unified set of SSAPs was that the SORP was "loaded with inconsistency and contradictory guidance" (Griffiths, 1999, p.14) and, in 1998 a process of SORP revision began in order to clarify and link the SORP to SSAPs. SORP 2000 *Accounting and Reporting by Charities* issued for charity reporting with effect from 1 January 2001 included a number of detailed changes, updates to allow for nine new SSAPs, and strengthened the requirements for non-financial information to detail the charity's main activities and achievements in respect of their objectives. As with previous SORPs, timely publication of annual accounts was required and the promulgations had force of law under the Charities (Accounts and Reports) Regulations 2000 (Charity Commission, 2003). Subsequently, a new Audit Practice Note was also released

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(Chitty, 2002). The SORP is reviewed annually with the most recent redevelopment effective 1 April 2005, and in 2003 a review process led to a Charities Bill, which is expected to be passed through Parliament in 2006.

Another task of the Commission is to "promote the effective use of charitable resources" (*Charities Act*, s.1[3]), yet despite evolving regulation to ensure higher levels of accountability, compliance lags. The Commission has therefore received increased government funding to facilitate its regulatory and monitoring role. With over 180,000 registered charities in the UK and an estimated 750,000 voluntary charity trustees (Chitty & Morgan, 2001), the task of the Charity Commission is extensive. Strategies to tackle the continued lack of compliance with SORP2[9] and tardiness in charity filings[10] continue, reflecting a failure of charities to meet sector specific accountability requirements.

The regulatory and educative cycle appears to have become the norm in the Charity Commission. Preparers have two incentives to prefer this: first, guidance in financial reporting will reduce exposure to litigation and increase legitimacy for the organization;[11] second, individual preparers seek to maintain currency in an externally influenced financial reporting market. The UK, as a member of the EU, needs to be responsive to EU Directives and has adopted IFRSs. The SORP, guidance notes, and regulatory umbrella of a Charity Commission provide a protective barrier for charities in the UK against the "full-frontal impact" of IFRSs development for profit-oriented entities, especially as the Government has not allowed charities to adopt IFRSs (Charity Commission, 2005a).

It thus appears that the impetus to undertake these costly exercises reflects an overwhelming desire by the sector and Charity Commission to ensure a special charity sector accountability that will provide sectoral comparability but is focused on charities and, in turn, specific guidance comforts charity officers and trustees. Fries (2003) confirms the importance in the UK of a framework that will allow charities to report on their activities in a transparent manner commensurate to their size and the level of public interest. The Charity Commission provides that framework, as well as undertaking supervision, advice, and guidance.

4. Emergence of charity regulators in New Zealand

The charity sector in New Zealand is much younger than the UK. From 1840, settlers from the UK to New Zealand brought a philanthropic attitude that was initially manifest in local activities such as Oddfellows and Friendly Societies. Friendly Societies practised ideals of self-help and self-reliance that became part of the Colonial ethos (Oliver, 1981, p.136). By 1884, there were 281 Friendly Societies in New Zealand with 21,000 members. Gradually church orphanages, refuges for prostitutes, private and public schools for uncontrolled children, and a patchy system of charitable aid administered through hospitals developed

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(Oliver, 1981, p.137). In 1884, the Society for the Protection of Women and Children was first established with a Dunedin branch. A New Zealand based charity to help mothers with babies, the Plunket Society, was later established in 1907. In 1885, the government passed the *Hospitals and Charitable Aid Act*. Old people's homes, hospitals and other charitable institutions were developed under the aegis of this Act, while the churches were also setting up City Missions, with the Salvation Army and Methodist Churches offering soup kitchens. Tennant (2001) suggests that although organized settlement in New Zealand coincided with a pendulum swing against public welfare, centralization of government in New Zealand enabled welfare policies to be implemented in a less contested way than other countries. The small size of settler New Zealand and subsequent strong personal relationships saw a "mixed economy of welfare" and close links between state and private charity (Tennant, 2001).

As well as indigenous charities, churches and government activities, there were also some imported movements. The last two decades of the nineteenth century saw the Women's Christian Temperance Union well established in settler New Zealand (Oliver, 1981, p.263). But it was not until the twentieth century that some of the extant international organizations extended branches into New Zealand. For example, the Red Cross was established in 1859, but was not introduced in New Zealand until 1914. Other international not-for-profit activities were those assisting children, such as Barnados, the Girl Guides and Scout movements; and the Royal Society for the Protection of Animals.

It could be argued that the rise of charitable organizations in new settler economies would not appear until the communities had grown large enough for people to become fragmented from the support networks that were characteristic of early settler society. This is premised on the assumption that immigrants arrived as families, or with connections. However, some were indentured to employers who had sponsored their boat fares, and these were among many familiar-isolated individuals who were relieved to be able to accept charitable aid. Further, we suggest that the revisionist view of early New Zealand society, as advocated by Fairburn's 1989 *The Ideal Society and Its Enemies: The Foundations of Modern New Zealand Society, 1850–1900*, requires rejection of an utopian lens viewing early settler ideals and motives. Fairburn identifies the utopian ideal was characterized by perceptions that New Zealand offered opportunities for labourers to win independence, abundance of natural resources, a high level of order (naturally created) and freedom from status anxiety. In contrast, Fairburn's (1989) examination of the ordered Wakefield settlements shows these were atypical of colonial society. The dominant condition was "frontier chaos", or "atomisation" of society. Characteristics of such societies were loneliness, transience, dispersed population, poor communications, material independence, drunkenness, violence, and litigation. In this context the more explicit egalitarian

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visions in early New Zealand settler society appear to have created a duality of tensions, so that, on the one hand communalism was encouraged, but on the other, pride in self-sufficiency reduced interdependence.

This dichotomy reflected on early New Zealand's charity regulatory process. While the *English Laws Act* 1848 mandated English law existing at 1840 as applicable to the New Zealand colony, the English Charity Commission structure was not established until 1853 and therefore was not imported. As in the UK in earlier periods, charity issues were dealt with by *ad hoc* measures to assist specific causes. The *Charitable Trusts Act* (1957) contained no financial reporting requirements, although charities incorporated under the *Incorporated Societies Act* (1908) and relevant Companies Acts were required to file financial accounts with the appropriate Registrar with audit compulsory only for companies. No regulatory body existed to monitor compliance and entities deemed charities by the tax authority were not constrained to file financial returns, leading to a lack of statistical data as well as a presumed reduction in transparency and accountability.

4.1. The charities commission

Accordingly, the New Zealand Society of Accountants initiated the Newberry report in 1992 (equivalent to the UK's Bird & Morgan-Jones 1981 report), which focused on the need for accountability to stakeholders. More than half of the sample of 29 charities provided financial accounts that displayed "basic accounting failures" (Newberry, 1992, p.18) and three quarters showed apparent audit failures. This paralleled the UK findings of Bird and Morgan-Jones (1981), and the Newberry report recommended that supplementary guidance be developed by the charity sector to augment the Accounting Standards developed by the Society. Further, Newberry (1992) recommended that the Society produce both a guide for auditors and develop an accounting standard especially for charities; but the sector-neutrality debate was to stymie this recommendation.

In 1988, Community Trust boards were formed from the restructuring of the Trustee Savings Banks in New Zealand. The banks had previously been a source of philanthropic funds and these new Boards were destined to become a major source of funds for sporting and community bodies. The government had sponsored a Working Party on Charities and Sporting Bodies (the "Russell Report") that called for greater accountability while offering incentives through changes to charities' taxes (New Zealand Working Party on Charities and Sporting Bodies, 1989). This was not received well by the sector and the Report's major recommendations were not implemented (McLay, 2002). Implementation of the Russell Report's recommendation to establish a Commission for Charities (to register, provide supervision and advice to charities) was indefinitely deferred as government believed further consultation was required (Caygill & Cullen, 1989).

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In 1990, an organization representing major fund raising bodies, Philanthropy New Zealand, was formed and set up a Working Party to determine a consensus on the means of improving accountability. Although self-regulation was preferred, the Working Party perceived that increased formalization of accountability was necessary for legitimacy and offered two alternatives: self-regulation with legislative underpinning, or formal donor protection systems underpinned by a uniform set of financial reporting standards for charities (Newell, 1997). However, neither option was adopted by the sector, perhaps because of sector diversity, lack of leadership and funding, or absence of a dominant group of advocates to organize and drive a regulatory entity.

Some 12 years after the Russell Report (1989), the government launched a discussion document titled "Tax and Charities" in 2001. This document generated 1682 submissions, a majority of which supported or accepted the need for registration. Yet there was divergence as to how, and through which body, this would occur (McLay, 2004). The sector had lost the window of opportunity to argue their capacity for self-regulation and a government Working Party began to frame the terms of reference that would form the first Charities Commission in New Zealand.

The result is the new *Charities Act* (2005) requiring registered charities to submit annual returns including financial accounts, but currently no separate financial reporting standards or mandated level of audit exist for this sector. Government is committed to augment charity registration fees with funding of the Charities Commission in the short term, acknowledging the UK experience of inappropriate funding levels that severely limited that Commission's effectiveness.

4.2. The sector-neutrality debate

During the formation period in New Zealand charities' attempts at self-regulation, the drive to sector-neutrality in New Zealand impacted financial reporting regulation. In the UK, the Accounting Standards Board issues Financial Reporting Standards aimed at general purpose financial reporting, leaving sector specific guidance to interested, qualified groups and requires the Charity Commission to review its SORP annually in order that any convergence with FRSs is gradual and sector-specific. Conversely, the New Zealand attitude to standard setting has been dominated in since 1994 by the emphasis on sector-neutrality.

Against a background of financial accounting reforms in the public sector and a requirement for Government accounting to be on an accrual basis under the *Public Finance Act* 1989, the Standards Board released seven exposure drafts entitled *A Proposed Framework for Financial Reporting in New Zealand*.[12] This *Framework* proposed the concepts to underlie the preparation of general-purpose external financial reports of all sectors; private, public and not-for-profit

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(including charities). For example, asset recognition depended on an item's future service potential or economic benefits, rather than the future economic benefits alone and the main objectives of financial reporting provided equal status to accountability along with the decision usefulness role. Accordingly, when the *Framework* was issued in its final form, Financial Reporting Standards applying to all entities were written underneath a comprehensive *Statement of Concepts for General Purpose Reporting*. Bradbury and Morley (2005) confirm that the result of having to consider particular accounting treatments to more than one sector with different ownership structures has resulted in a rigorous standard-setting process. However, Hodges and Mellett (2003) suggest that when a standard setting body has responsibility for sector-neutral standards (as in New Zealand), the considerations of the marketplace or private sector is stronger, due to the influence of multiple sector representatives in the standard setting process.

For example, ED-70 "Discussion Paper on Accounting for Grants and Donations" was issued in 1993 to revise SSAP-16 "Accounting for Government Grants", which "was written from a private sector perspective" (New Zealand Society of Accountants, 1993, para. 2–695). However, ED-70 was withdrawn due to wide, unresolved debates and also variances in recommended practice in other jurisdictions with SSAP-16 being withdrawn shortly thereafter (Baskerville, 1995).[13] This encapsulated the debate on revenue recognition, and the likely constituency rejection of a strong conceptual basis that should apply to revenue recognition by all entities, especially the large governmental entities that would have been subject to all such standards. Instead, the Society released a Research Bulletin, R-120 "Financial Reporting by Voluntary Sector Agencies", in 1999 seeking to provide some guidance on charity reporting. Anecdotal evidence suggests this attracted a relatively low readership, and there have been no updates to reflect the emerging nature of financial reporting standards.

Although during the formative period the accounting profession had been involved with developing reporting guidelines, unlike the UK, the New Zealand professional body has not maintained a comprehensive set of sector-specific accounting recommendations.[14] Neither had it actively promoted the Guidance Notes it did offer. This apathy may be related to the heterogeneous nature of the sector, as recommendations from strong and homogeneous sectors had been championed more effectively.[15] Despite Khumawala and Gordon (1997) noting that just having the "right" standards does not improve accountability on its own, the increasing demands of the New Zealand Charities Commission will mean that its economic agents are likely to seek comprehensive guidance to reduce risk (Reinstein & Bayou, 1998), including pressuring the Charities Commission itself to provide reporting guidance. Already members have challenged the New Zealand profession to establish a not-for-profit taskforce to help the sector meet its accountability objectives (Anon, 2005).

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Despite Newberry (1995), Barton (1999) and others continuing to question the relevance of the *Statement of Concepts* to the charity sector, the Institute has maintained its programme to produce sector-neutral standards, requiring consistency of treatment for transactions and events, no matter the entity involved. Thus, the Institute and the Financial Reporting Standards Board have both adopted an assumption of a sufficient degree of similarity between accountability demanded of charities compared with other entities in the public benefit sector, and the private sphere, to retain sector-neutrality in standard setting processes in New Zealand. Clearly they believe this advantageous to members, users and preparers. This is evidently different from the UK and contrasts to the UK's cycle of a SORP, which converges and then over time diverges from the financial reporting standards on issue. New Zealand entities, regardless of sector, all use IFRSs, with some adaptations instituted by the New Zealand regulators.

5. Key similarities and differences between jurisdictions in New Zealand and the UK

5.1. The functions of and reasons for a commission

The foregoing sections have considered the interplay between the charity sector, the accounting profession, and government in establishing charity regulators in both the UK and New Zealand. The stated aims of a Commission in both countries are to register, monitor, and regulate the charity institutions. The objectives are also similar, as there is an "overriding aim to promote public confidence in the charitable sector" (UK National Audit Office, 2004, p.1) by providing an oversight body. Registration alone will not achieve public assurance of an accountable and transparent sector, however ongoing monitoring and advice may well be strategies that will see these aims come to fruition.

5.2. Monitoring and advice to enhance accountability

The New Zealand and UK governments have called for accountability both to government as funders and for donors. Accountability is also required to beneficiaries (Institute of Chartered Accountants of New Zealand, 1999, p.10). Yet Hyndman (1990, 1991) finds the existence of a "relevance gap" in the UK, due to a lack of considered and imaginative reporting that does not speak the language stakeholders require for accountability (Stewart, 1984). An independent monitoring body can help to bridge the gap by mandating specific disclosures. Alternatively, the monitoring and education areas are perceived by the charity sector (as preparers) as the most beneficial functions of a regulator (Handley, 2004). The UK Charity Commissioners publish guidelines for sector reporting and also for officers' duties, and are a proactive charity agent encouraging operational improvements in the sector, concerned to enhance its reputation.

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The New Zealand Charities Commission will compete with similar government sponsored bodies such as the Accounting Standards Review Board and the Securities Commission. This may reduce its ability to take a proactive stance. However, the UK experience shows that monitoring and advice engenders beneficial levels of engagements from the sector and increasing levels of compliant reporting.

5.3. Reporting standards to enhance transparency and comparability

It has been said that no one set of accounting rules can best represent the activities of a group of heterogeneous organizations (Parsons, 2003) and the heterogeneous nature of the charity sector has been noted. Self-regulation has had mixed success, particularly in countries where there is a large number of charitable bodies; therefore it has been argued that legislative support is required to ensure generally accepted standards are widely followed (Godfrey *et al.*, 2003). When a sector works with a regulator, sector participants appear more likely to follow the standards imposed (Klumpes & Manson, 2000). Furthermore, these standards increase comparability within a user needs model, leading to increased transparency and confidence, giving rise to increased support. In the charity sector a regulator is most likely to escape capture due to a lack of homogeneity between users, and accordingly work for all stakeholders.

The well-established UK Charity Commission has gradually moved to support and develop the sector, augmenting its registration duties through prescriptive SORPs and other publications which avoid preparer "standard overload" and provide certainty in interpretation, a model also mirrored in the FRSSEs on issue. Readily available sector statistics, available since the 1960 Act, provide an improved information base that informs policy makers and stakeholders as to the size, depth and accountability of the sector. Accordingly, resources have been released to enable the Charity Commission to build a protective barrier against IFRSs for registered charities.

Registration is currently the cornerstone of New Zealand charity regulation with financial reporting responsibilities defined in sector-neutral terms requiring compliance with IFRSs. Many professionals employed in charities in New Zealand are aware of overseas models (especially the UK) and have been active in calling for the more supportive and prescriptive layer of bureaucracy that exists there to be replicated in New Zealand. Yet the Charities Commission, a new initiative, was embarked upon in New Zealand only once self-regulation had failed. To imitate the UK model of financial reporting in opposition to the extant sector-neutral stance would require a fundamental paradigm shift in New Zealand. Furthermore, lack of charity statistics does nothing to alleviate perceptions that the charity sector is unimportant. When this combines with under-resourcing of New Zealand's regulatory bodies, the results are as yet a far cry from the improvements in financial reporting seen in the UK.

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6. Conclusion

Common philanthropic attitudes gave rise to charities in both the UK and settler New Zealand. Yet, the concept of charitable purpose, attuned to the public good, evolves and may be country-specific and, as well, the funding of charitable work will depend on interchange between communities and government as well as charities. The call to accountability is, however, increasing and has included demands for comparable financial and non-financial information witnessing increased charity regulation. The UK has elected to enforce a special construction of accountability for charities preferring to provide technical assistance to preparers despite the resource commitment required. Conversely, New Zealand is a jurisdiction that has offered a sector-neutral approach to charity financial regulation maintaining a conceptual consistency to the delivery of accountability, despite technical difficulties.

The current processes of international harmonization in both these jurisdictions through the required adoption of IFRSs, is more than meeting the needs of multinational enterprises; the current moves to IFRSs are premised on the principle that accounting conceptual frameworks should not be jurisdiction-specific. Yet the manner in which this leads to a proliferation of standards for separate sectors, for example private, public, not-for-profit and charities – many without a conceptual framework – may encourage *ad hoc* changes to respond to political lobbying. In the UK this has led to periods of divergence and convergence in financial reporting standards applying to some entities. Divergence increases the load on preparers, attesters and users and may lead to lower levels of accountability and transparency.

Conversely, the general nature of sector-neutral standards leads to appeals for specific disclosure standards from individual sectors, as preparers and attesters seek to limit their liability and users require higher levels of comparability. However, there is a danger that considerations of the marketplace take precedence over other sectors. Despite political pressure in New Zealand on the profession to explore more definitive ways to support the not-for-profit sector and charities specifically, the overriding commitment to sector-neutrality and IFRSs for all financial reporting now offers a large set of IFRS-adapted standards for all sectors. However, these are unlikely to be conceptually resonant with, or cost-benefit efficient for, charity user needs.

Charities are becoming more highly regulated worldwide while subject to diverse financial reporting standards. This review has illustrated that this may be attributed to different drivers in two otherwise similar jurisdictions.

Notes

1. Also known as the Statute of Elizabeth (Brown, 2002).
2. By the passing of the *Mortmain and Charitable Uses Act* 1888.

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3. Specifically in the 1996 Ontario, Canada Law Reform Commission "Report on the Law of Charities" and the July 2002 "Report of the Law Reform Committee of the Law Society of Ireland" (Gousmett, 2003).
4. By 1976 the ASC was a collaborative effort with representatives from other UK accounting bodies such as ACCA, CIMA, ICAS, ICAI and CIPFA.
5. In Northern Ireland and Scotland, these accounts are provided to the Inland Revenue.
6. See for example Klumpes and Manson (2000), who find higher levels of compliance from UK Pension Schemes with an industry (or preparer) developed SORP. Australian research shows low levels of compliance with a standard developed by accounting regulators that is more focused on defending the interests of stakeholders.
7. The negative assurance was confirmation by the ASB that no conflict existed between SORP and the accounting standards then current (Palmer & Vinten, 1998).
8. In 2004, this would have been over 11,000 charities whose aggregate annual income is £29.8 billion, or 94 per cent of the total sector's earnings (Charity Commission, 2004).
9. Palmer *et al.* (2001) found that diverse reporting practices of over a third of the 125 top charities caused non-compliance with SORP.
10. For the year ended 31 March 2003, over one-third of charities missed the 10-month deadline (Hillsdon, 2003).
11. As well as SORP2, those involved in preparation and assurance for charity reporting have sought publication of guidance notes and minor SORPs for sub-sections of the sector from the Charity Commission. The Charity Commission has released SORPs for registered social landlords, common investment funds and the higher education sector. Also, guidance notes have been developed for independent schools and parochial church councils as well as cathedrals. The Scout Association has produced guidance notes on SORP2, as has the Department of Culture, Media and Sport (Chitty & Morgan, 2001).
12. The statements include an Explanatory Forword, Statement of Concepts, Public Sector Guide to the Statement of Concepts; two statements relating to Differential Reporting; Disclosure of Accounting Policies and Presentation of Financial Reports.
13. In 1996, the Society was renamed the Institute of Chartered Accountants in New Zealand.
14. Even when R-120 "Financial Reporting by Voluntary Sector Agencies" was issued in 1999, it was neither widely published, nor updated, reducing its relevance in an ever-changing environment.
15. For example, FRS 14: "Accounting for Construction Contracts", FRS 34: "Life Insurance Business".

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