Financial Reporting

Control Relationships

In the new financial reporting regime there is attention given to not only the numbers but the need to tell a story about what your parish, Synod or other registered charity does, the resources used in doing it, and how well positioned you are to continue doing it. To tell this story, some Methodist Church charities will need to consider whether they have control relationships with other organisations. If a charity has control relationships, this could affect the story that needs to be told, and the reporting tier that the charity is eligible to use.

Some charities set up separate organisations to carry out their different activities. For example, a Parish might establish a separate trust to manage its properties, its Op Shop, child care facilities, etc. In these situations, the Parish is likely to have a 'control relationship' with the trust or incorporated society – if so, the Parish will need to include information about them in its reports.

How can this affect the reporting tier?

If a Tier 1, Tier 2 or Tier 3 registered charity has control relationships with other organisations, these organisations are considered part of the charity's 'reporting entity'. Please remember that we are looking at 'control' and 'benefits' from a financial reporting point of view and what is required by financial reporting standards. Charities in this situation will need to include information about these organisations in their performance reports (financial statements) by providing 'consolidated financial statements'. In such cases, the combined expenditure of the charity and the organisation/s they have a control relationship with, could mean that the charity is required to report in a higher tier. The combined expenditure does not include transactions between the organisations within the reporting entity.

For example, a Parish's annual expenses are $750,000 (thereby qualifying for Tier 3), the annual expenses of a separate organisation they control are $1.5 million, and they calculate the expense transactions between the two organisations were $100,000. The combined expenditure would be $2.15 million and the charity would be required to report in Tier 2. In many cases within the Methodist Church, the consolidated parish accounts will still remain under $2.0 million and therefore the Parish accounts will remain a Tier 3 reporting entity.

Tier 4 registered charities do not need to prepare consolidated financial statements and control relationships will not affect their reporting tier. However, as part of the requirements of the Tier 4 Standard, a Tier 4 charity would need to describe its structure in the performance report, including the nature of any control relationships it has. A Tier 4 registered charity can choose to report using the Tier 3 Standard and prepare consolidated financial statements if they wish. However, if a Tier 4 reporting entity does choose to report using the Tier 3 reporting standards, they need to apply ALL of the standards and not "cherry pick" which parts to use and not use.

Why do we have to consolidate?

The Tier 3 reporting standard provides as follows:

4. This Standard applies to an entity that is required to prepare a performance report. The Standard applies to the performance report of single entities and entities that have certain interests in other entities.

> *4.1 When preparing a performance report, an entity is required to identify its interests in other entities and assess whether, for the purposes of financial reporting, any of those interests result in the other entity meeting the definition of a controlled entity, an associate or a joint venture.*
>
> ***4.2 If an entity controls another entity it shall prepare a consolidated performance report which combines the assets, liabilities, net assets/equity, revenue and expenses of the controlling entity with those of the controlled entity in accordance with the requirements in PBE IPSAS 6 (NFP) Consolidated and Separate Financial Statements (Not-for-profit).***
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> *4.3 If an entity has an interest in an associate it shall prepare a performance report in which it accounts for that interest in accordance with the requirements in PBE IPSAS 7 Investments in Associates.*
>
> *4.4 If an entity has an interest in a joint venture it shall prepare a performance report in which it accounts for that interest in accordance with the requirements in PBE IPSAS 8 Interests in Joint Ventures.*
>
> *4.5 When applying the requirements in PBE IPSAS 6 (NFP), PBE IPSAS 7 or PBE IPSAS 8 an entity may use any Reduced Disclosure Regime (RDR) concessions available to Tier 2 entities in those standards. RDR concessions are denoted with an asterisk (*) or an RDR reference in front of a paragraph.*
>
> *4.6 If an entity has an interest in another entity that is not a controlled entity, an associate or joint venture it accounts for that interest in accordance with the requirements on investments in Section 6 of this Standard.*

What are consolidated financial statements?

Consolidated financial statements present information about a charity and the organisations it controls as one single entity (i.e., the ‘reporting entity’). The charity combines its assets, liabilities, equity, income, expenses and cash flows with those of any organisations it controls. Where charities also provide non-financial service performance information (such as purpose, outcomes and outputs), this information is also combined in the consolidated statements.

What is control?

‘Control’ for financial reporting purposes is the ‘power’ to govern the financial and operating policies of another organisation in order to ‘benefit’ from its activities. There must generally be both ‘power’ and ‘benefit’ for a control relationship to exist. **The benefits can be both financial and non-financial in nature.**

Some indicators of power and benefit are outlined in the table below.

Indicators of power	Indicators of benefit
The charity **has the ability** to: • veto, overrule or modify decisions of the organisation's governing group • appoint or remove members from the organisation's governing group • set or modify policy about how revenue is raised or how money is spent by the organisation, or • close or wind up the organisation.	The charity benefits by: • receiving all or a portion of the organisation's profits/surplus, or even being responsible for the organisation's losses (negative benefit), or • the organisation provides goods or services which contribute to the charity's objectives.

Determining whether charities have this control relationship can be complex. It involves an exercise of judgement, after considering the definition of control and the nature of the relationships between the organisations concerned. Control of an organisation can be attained in a variety of ways, and the underlying circumstances will vary.

It should be noted that the standard that deals with control and benefits does not only deal with the actual use of power but also the ability to control, that is to say, just because a parish or other registered charity does not use its power to control the mere fact that it has that ability may be a contributing factor in determining if control exits.

Examples of a control relationship

Scenario one

A Parish (which is a separately registered charity) sets up a separate trust called Blue River. The purpose of Blue River is to sell second hand clothing and distribute any surplus to other registered charities. Blue River is set up as a charitable trust, which keeps the finances and management separate from that of the Parish. The Blue River governing board is made up of members of the community and members of the Parish. The charity appoints the Chair and is also able to veto any person nominated for the Blue River's governing board.

The charity's ability to appoint the Chair and to veto, is an indicator of **power**. The charity **benefits** by achieving some of its objectives through the reduction of pollution of local streams and rivers. This indicates that the charity has a control relationship with Blue River.

More information

If you think that you may have a control relationship with another organisation, you should refer the matter to the Connexional Office, your qualified auditor (if you have one) or refer to the standards and guidance material on the External Reporting Board's website, www.xrb.govt.nz, to decide how this may affect its financial reporting.

Relevant documents include:

- **PBE IPSAS 6 (NFP):** Consolidated and separate financial statements,
- **EG A8:** The Reporting Entity, and
- **EG A9:** Identifying Relationships for Financial Reporting Purposes.

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