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Impact in action

How can charities in New Zealand and around the world measure impact to achieve their mission?

How ready is your Board to respond to stakeholder demands?

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Will your business qualify for the new R&D tax credits?

Taking out a new lease? Here's 8 key considerations for CFOs.

The alphabet soup of compliance just got a little bigger

VOLUNTEER
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Impact in action

How can charities in New Zealand and around the world measure impact to achieve their mission?

Impact is a measure of how charities are implementing their strategy and advancing their mission successfully. This is critical to effective governance now more than ever - global charitable giving is down, and in some countries, negative headlines have caused the public's trust in charities to waver. There are also questions over how donations are used to help the causes they support.

Measuring the genuine impact of work allows charities to demonstrate the most accurate results possible to funders and stakeholders. Knowing this true impact helps inform future strategy and helps charities to understand the risks of failure and the benefits of success.

Latest research from Grant Thornton International, *Impact in Action*, which was released September 2018, explores the importance of impact measurement and is aimed at helping charities better define impact and enhance measurement and reporting; it also provides practical tools in response to the ever-increasing demand for impact-based practices.

Impact can also mean different things to different Not for Profit organisations, and while there is no single solution to help every charity measure and report impact more effectively, our research also offers a series of recommendations for charities to consider on their impact journey.

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1 Don't tackle too much at once

Charities we spoke to agreed that sometimes focusing on less is actually more. To have the best chance of success, specific areas need to be targeted for impact measurement. Attempting to measure the impact of everything all at once is likely to lead to ineffective results.

2 Conduct a skills/resource gap audit

To improve current impact measurement capabilities, Not for Profits should honestly assess whether new technology, third party support, new staff, or upskilling existing staff would be useful investments for their organisations. They should also look at a potential skills audit for their Boards and management teams as well.

3 Agree parameters and stick to them

Charities should be asking themselves, "What are the key outcomes that would demonstrate that the strategy is working?" As part of the research project, we interviewed Stephen Goodman, CEO at Volunteer Service Abroad who pointed out that stakeholders need to understand that genuine outcomes that support an organisation's mission may take years to come to light. He says, "We have to be very careful that we don't shape our impact reporting around today's solution or challenge. Because in five years' time it might look quite different. If we are trying to measure against an outcome that we see as relevant today, we may actually miss the boat".

4 Verify your results before you share them

Sharing results which can be picked apart or undermined could do more harm than good. Explore who is best placed within your teams to carry out the verification process. Grant Thornton New Zealand's head of Not for Profit services, Brent Kennerley says that, "There is often a blend of quantitative and qualitative evidence to analyse, both of which will likely play a role in telling your impact story. Consider whether you have people trained in analysis of both forms of results to draw the best conclusions, and seek training or extra support if not".

5 Empower your team to act as advocates

While conducting research for the report, a common thread in our conversations with clients and other industry leaders was the need to get the right people to sell the impact story – people with passion who believe in it. It's also beneficial to empower other staff members to act as advocates by involving them in the early stages, when you are setting the parameters of what to measure and how.

6 Don't be afraid to tell your story your way

Naturally, the medium and format used to communicate your impact will vary depending on the audience. However, whether communicating with a Board, investor or the public in general, an organisation's story should always cover the following core components:

1. We believe our mission is crucial because…
2. You have provided money/time/support to help us achieve our mission
3. These are the outcomes we have achieved
4. This is how those outcomes support our mission

For a deeper dive into impact reporting, visit **grantthornton.co.nz/insights** to download our report, *Impact in action*. If you'd like even more insights, feel free to reach out to our head of Not for Profit Services.

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How ready is your Board to respond to stakeholder demands?

Effective governance in a fast-shifting marketplace requires the ability to marry together engagement, information and risks.

The relationship between Boards and stakeholders is evolving with a growing need for greater engagement and transparency.

Grant Thornton International's report, *'Engagement beyond the Boardroom: What do your stakeholders expect?'* is based on a survey of business leaders from 35 economies who are experiencing growing pressure to collect and respond to views of wider stakeholders (such as employees, customers and suppliers). In some markets, more than 70 percent of survey respondents feel the pressure to increase stakeholder engagement has increased over the past two years.

Tackling the challenges of corporate governance is not easy and there is no one size fits all approach. However, there are guidelines that any business can take in to consideration.

Know your target group

Stakeholders want to be involved and influence both the make-up of the Board and its direction. Organisations and their Boards should understand who their key stakeholders are, what impact your organisation has on them, and what impact they have on you (eg, influencing your reputation or ability to operate). For example, if your business impacts an entire community, it's important to determine which community leaders and influencers to engage with directly, what concerns they may have and how you can address them.

It's also important to remember key stakeholders today may not be your key stakeholders tomorrow. Boards need to recognise there is a need for constant evaluation of who your key stakeholders and target groups are, and the influence they have. New Zealand's population demographic is a lot more diverse than it once was; for example our growing aging population is becoming a huge political force - ignore them at your peril!

Structure the feedback and response

From time to time an issue may erupt, thrusting a business into news headlines for the wrong reasons. How these situations are handled are crucial. Handled poorly and the business' reputation can be severely tarnished; handled correctly and the issue will merely be a blip on the radar.

A good practice is to clearly set out who should take the lead in communicating with different stakeholders and how the dialogue will be built into decision-making. For example, corporate governance manifests itself best when people are genuinely honest, own up to mistakes and then resolve not to repeat them.

Broaden your management and external reporting

Integrated reporting provides a good starting point for assessing and communicating your social and environmental impact, and other data of relevance to your business and stakeholders. Generally speaking, New Zealand businesses have been slow on the uptake of integrated reporting; one reason for this is the misconception that it will cost more. There is also a general lack of

knowledge about integrated reporting and what it is designed to achieve. The reality is that integrated reporting offers greater transparency about the sustainability of the organisation, and it can also save your business money through lowering your cost of capital because it is directly reporting on short, medium and longer term aspirations of the reporting entity.

People want to understand what your business model is, and where the Board is focusing most of its attention (your integrated thinking) and how that thinking is being translated into actions and decisions for the organisation. The winners in this space are the organisations that can best tell their story of transformation and change over time.

Determine the right composition for your Board

Gender diversity has been at the forefront of debate recently as the private sector lags behind the public in achieving Board diversity. Diverse Boards bring fresh ideas, challenge assumptions and enable your business to better reflect the breadth of perspective within your customer base. Research Grant Thornton conducted in 2015 revealed that companies with diverse executive Boards offer higher returns on investment compared with those run solely by all-males. The study covered listed companies in India, UK and US and estimated the opportunity cost for companies with male-only executive Boards (in terms of lower returns on assets) at a staggering US$655 billion in 2014. It's clear that caution is required as we proceed ahead in navigating to find a solution in achieving a better balance.

There are organisations trying to address different types of diversity in business. One example is the Institute of Directors' mentoring programmes which, for the last five years, has paired approximately 20 people each year to shadow an equal number of independent directors at Board meetings. This provides experience from observing how decisions are made. All credit to the IOD for not only instigating but carrying out the programme which is starting to produce a new generation of decision makers.

Validate and challenge

As a Board member, you're on the hook for what your business does. So, how much do you trust the information you use to run the business and is it subject to sufficient validation and challenge?

A useful way to check whether the information coming from inside your business is suitably credible and relevant is to compare against the 'control' of what third parties are saying about your organisation, including your key stakeholders. The biggest risk is a 'good news culture' in which your employees feed you with the information they think you want to hear, rather than what you need to hear.

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Are you prepared?

Stakeholders demand transparency now more than ever. Organisations are held accountable for accuracy and integrity in their business operations and they must have effective and reliable governance and compliance procedures in place. Additionally, they must understand and manage risk and seek an appropriate balance between risk and opportunities. Download the full report for further insights into engagement beyond the boardroom by visiting **grantthornton.co.nz/insights.**

Will your business qualify for the new R&D tax credits?

Earlier this year, the Government released a proposal to incentivise Research and Development (R&D) activity for New Zealand based companies via a new tax credit regime. Draft legislation has since been released, with the new R&D tax credits expected to be available from the tax year commencing 1 April 2019.

Increasing R&D activity in New Zealand through government incentives has been subject of various initiatives over the years. The Labour Government previously introduced similar measures in 2008. These were only in operation for one year before being repealed by the subsequent National Government. Some years later, National introduced their own R&D 'cash out' incentive, aimed at start-ups with high R&D intensity activities. These latter credits continue to be available for now, but as is the nature of these politically charged incentives, indications are the existing 'cash out' system will soon change to align with the new R&D credit regime being introduced.

There is potential for taxpayers to receive significant benefits from this regime.

There is potential for taxpayers to receive significant benefits from this regime. Any business involved in or considering R&D activity needs to seriously consider whether they can take advantage of the tax credit or cash out provisions to increase funding in their business, reduce their overall tax cost or facilitate R&D activity not previously contemplated. With broader eligibility criteria, even businesses who have been unsuccessful in previous R&D tax credit claims may find new opportunities with this regime.

Key features

- R&D credits can be used to reduce a qualifying taxpayer's tax liability by up to 15% of qualifying R&D expenditure (up to a $120million maximum)
- The credits will be available for use in the year the expenditure arises, or in future years (provided minimum shareholder continuity requirements are met)
- To qualify for the expenditure, a business must have a minimum spend of $50,000 on R&D. Lower R&D spends may qualify if the activity is undertaken through an approved research provider
- Tax credits will be refundable up to $255,000, with requirements mirroring the R&D tax-loss cash-out scheme already in place. This will be reviewed, with potential changes from 1 April 2020
- A person is excluded from the R&D tax credit regime if they receive a Callaghan Innovation Growth Grant for the relevant income year; the Growth Grants scheme will be phased out as the tax credit comes in

So who will qualify for the new R&D credits, and is it worth the time and effort to get them?

To receive the R&D tax credit, a business must meet tests under three categories: the person who is claiming the credit, the type of activity, and the type of expenditure. Importantly, business as usual expenditure will not qualify.
The key requirements are as follows.

- **The person who is claiming the credit:**
  - performs core R&D activity in New Zealand, or a contractor performs a core activity on their behalf
  - carries on business through a fixed establishment in New Zealand
  - has R&D controlling rights over the research and development activities. This broadly means they either own the results of the R&D activities, are able to use the results without providing additional consideration, or a company in the person's corporate group owns the results and the company is resident in a country with which New Zealand has a double tax agreement.
- **The type of activity that qualifies as eligible R&D:**
  - is conducted using a scientific approach
  - resolves scientific and technological uncertainty.
- **The type of expenditure that qualifies as eligible R&D expenditure:**
  - includes employee salaries, expenditure on consumables and depreciation loss for assets used in R&D
  - does not cover specific exclusions; some of these include routine software and computer maintenance, patenting and licensing costs, market research, management studies or activities relating to organisational design.

In the 2008 R&D tax credit regime, it was estimated that that over 40% of claims related to software development – we are expecting this may also be a significant area for R&D tax credit claims this time around. Interestingly, expenditure on certain internal software development will qualify under this R&D tax credit regime - subject to a $3 million cap. Given the size of the cap, for many small to medium size businesses it may still be worth considering if upcoming software expenditure could qualify.

Where to from here?

Now that draft legislation is available, we are predicting an increase in businesses wanting to assess their eligibility for the credits.

1. **Start early and plan well**
   It pays to start planning early. It's important to ensure that the claim is well framed and that the relevant details about the expenditure are recorded as they are incurred.
2. **Take advice on eligibility**
   Given the detailed nature of the expected rules - at least in the first year - most businesses will need specific tax advice about whether a credit is available before making a claim. Not all expenditure of the types listed above will be included; availability will come down to the facts about the expenditure and the wider question of where 'scientific or technological uncertainty' lies.
   A tax advisor will be able to let you know at an early stage if there are criteria which disqualify the expenditure, and they can work with you to refine the expenditure types to only those with a viable chance of a claim.
3. **Collect data on the types of R&D activity in your business**
   There is an array of different R&D projects and activities that will qualify for the R&D tax incentive – the challenge for many businesses will be determining whether they have one of these. Some may have recurrent expenditure of the qualifying type, and identifying this early will have ongoing benefits.
   Places to look will include in expenditure on experimental development, basic or applied research or knowledge acquisition. This will particularly be the case where the activity is implemented to create or enhance:
   - materials
   - products or devices
   - processes
   - services.

The best approach is to summarise all types of expenditure which may fall into these categories so these can be fully considered.

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Taking out a new lease?

Here's 8 key considerations for CFOs.

The introduction of a new international reporting standard is set to add billions of dollars to balance sheets in New Zealand and around the globe.

NZ IFRS 16 has the potential to significantly change what you currently report in your financial statements. Because leases are contractual obligations, they will need to be reflected as a liability in financial statements from 1 January 2019 with exceptions for low-value and short-term leases.

Here are eight key considerations for every CFO before entering into future contractual arrangements to lease assets.

1 Let's start with tax

Nothing is more certain in life than tax and more taxes, so of course it warrants a mention here. We've looked at the tax implications that might emerge from the transition to NZ IFRS 16, and rather surprisingly, both the current and deferred tax consequences are unlikely to be significant. This might come as surprise, but given the mechanics of accounting for deferred tax are largely procedurally driven, and lease assets and lease liabilities appearing on both sides of the balance sheet will be approximately the same, from our analysis there appears to be no skeletons in the closet.

The Tax Working Group briefly looked at the topic of leasing as well. The group reconfirmed that under current legislation there are tax consequences when lease inducements and surrender payments are made and it doesn't have not plans to change this. The group also observed that the grant, renewal and/or transfer of leasehold assets is currently very complex and the process could be simplified. Finally, they also noted that the realisation of leasehold interests should be revisited because there's not always a taxable consequence and probably there should be. However, outside of those brief observations, very little was said about leases and leasing in general.

2 Financial covenants

If you lease assets and have tight debt to equity ratios, the new requirements will almost certainly make your situation worse. All significant lease commitments will be deemed a financial liability and need to be recognised in the statement of financial position. There will no longer be a distinction between operating and finance leases for lessees so leverage and capital ratios will deteriorate when the new standard comes into effect. Existing bank covenants will most likely be breached and therefore an up front communication with your bankers will be critical.

3 Renewal arrangements

If it is reasonably certain that the lease arrangements you enter into will extend into a second or third term, then this must be taken into consideration when determining the lease liability that you must reflect in your balance sheet. The longer you lease an asset, the greater the lease liability that will need to be recognised at inception.

4 Contingent rental conditions or residual value guarantees

To ensure that the liability (and of course the corresponding "right-to-use" asset) is not understated in the balance sheet, some additional elements now need to be taken into consideration. When issuing the new standard, the goal was to include these factors into the determination of the liability to reflect the economic substance of the arrangement – taking into account all, not just some, of the cash flows associated with the leasing arrangement. Term option penalties and residual guarantees all now need to be explicitly taken into consideration. Variable payments that depend on an index or rate should be included in lease liability/asset based on using index/rate at the commencement date. So, be careful - other variable payments (eg, payments linked to sale or usage) are excluded from the lease liability/asset.

5 Changing the lease period after entering the contract

If you need to change the lease period after signing the contract, NZ IFRS 16 now requires you to recalculate your obligations under the leasing arrangement and adjust the financial statements accordingly. For some this will not be a huge imposition, but if you are a large and complex organisation with hundreds of lease contacts, this has the potential to be hugely time consuming.

6 Tracking your lease arrangements

If you're using Excel spreadsheets to record and track your leasing arrangements, the advent of NZ IFRS 16 means that this will no longer be a suitable platform for many organisations. It can be argued there is a time and a place for everything, but now might be a good time to evaluate the robustness of the controls and systems that support your lease accounting processes because in many instances an upgrade may be needed.

7 Staff performance incentives based on operating cash flows or EBITDA basis

There will no longer be straight line recognition of rent expense in profit or loss (unless the exemptions for short-term leases and low value assets are adopted). Lessees rent expense will end up being front-loaded because of the interaction of effective interest being used to reduce the recognised financial liability coupled with the depreciation of the "right to use" asset. Because interest and deprecation will "replace" rent expense, EBITDA and operating cash flows will increase when the standard comes into effect. While some may conclude that the difference in the expense profile between NZ IFRS 16 and NZ IAS 17 will be insignificant for many companies that hold an evenly distributed portfolio of leases, it's important not to overlook the need to make sure remuneration protocols built around EBITDA results are also considered.

8 Lessees who are also lessors

The good news is that accounting by lessors is not materially changed. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types differently. However, you need to be mindful that there are enhanced disclosures to be provided by lessors that will improve information disclosed about a lessor's risk exposure, particularly to residual value risk.

While these considerations are important, like most financial reporting standards, the devil is in the detail and there will no doubt be more to consider. If your organisation is a public benefit entity (ie, a public sector or Not for Profit organisation), the good news is that for the foreseeable future, these changes are unlikely to impact you.

However, if you are a for profit enterprise that is required to follow general purpose financial reporting, now is the time to consider the future implications of this new standard because, whether you chose to adopt it early or not, it has the potential to significantly reshape future financial statements.

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The alphabet soup of compliance just got a little bigger

Just when you thought there couldn't be any more acronyms in the legal and accounting world, FATCA, CRS and AML are now new additions to the alphabet soup of compliance.

The ease in which people have historically been able to invest money outside their home country has provided prime opportunities for aggressive tax planning and in some cases, blatant tax evasion. To detect, track and prevent this, the United States Foreign Account Tax Compliance Act (FACTA) and the Common Reporting Standard (CRS) have been established. Virtually every Government in the world has agreed to participate in these regimes by exchanging information about assets held by their financial institutions.

For example, if a financial institution in Australia holds financial assets for a resident of New Zealand, then information about the account and the people who control it will be exchanged between the Australian and New Zealand tax authorities.

Although this seems simple enough, one of the conceptually challenging aspects of FATCA and CRS is that the regimes capture trusts, companies and other

entities due to the common perception that they are sometimes used to avoid or evade tax. We expect it will mostly impact Trusts. Another, quite controversial, aspect of the regimes is that registration may be required even where there is no foreign resident account holder or beneficiary.

Despite these controversies, FATCA and CRS are now part of New Zealand law and non-compliance may have adverse implications for both the Trusts and the trustees, including penalties being imposed under the Tax Administration Act 1994. Furthermore, banking facilities may be compromised as the banks, in particular, are taking compliance very seriously.

FATCA and CRS are part of a paradigm shift in the ways laws are being enforced globally. Another example is the Anti-Money Laundering and Countering of Terrorism Financing Act 2009 ('AML'), which originally came into force from 30 June 2013, covering financial institutions and casinos. Phase 2 implementation of the Act is currently underway to include certain non-financial businesses and professions. From 1 July 2018, this extended to lawyers, and from 1 October 2018 it includes accounting practices.

Essentially, governments, tax authorities and law enforcement agencies are shifting the burden of enforcing these laws onto financial institutions, professionals and other businesses who service these clients. This is being achieved by imposing legal obligations and significant penalties for non-compliance on those intermediaries.

How do I comply?

The first step is to ascertain whether the Trust is caught by these regimes. If this is the case, then a number of obligations follow including the preparation of documentation setting out the details of people associated with the Trust, and reporting to the United States Internal Revenue Service (IRS) and New Zealand Inland Revenue Department (IRD) where required. In some cases, annual reporting will be necessary.

If FATCA and CRS don't apply, then compliance should be relatively straightforward, but some action may still be necessary. Depending on the nature and structure of your Trust, your advisor may be contacting you for further information. So, please bear with your bank, your lawyers, and your advisors if they begin requesting additional information required under CRS, FATCA or AML, as they navigate the complexities of "the new world order of compliance".

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