

Practitioners Advisory Group Issue Paper

AGENDA ITEM: PAGCP03-02

17 June 2020 – Online

Extracts from CP Part 1: Section 1 and Section 5

Summary	The paper provides extracts from updated drafts of Part 1 of the Consultation Paper concerning the definition of NPOs in the scope of the Guidance and the proposed straw man model for developing the Guidance.
Purpose/Objective of the paper	To provide PAG members with an opportunity to comment on the most up to date drafts of these sections of CP Part 1 which reflect feedback from the TAG.
Other supporting items	TAGCP08-01 Feedback on CP Part 1: here TAGCP09-02 Preface and CP Part 1 Updates: here
Prepared by	Philip Trotter
Actions for this meeting	Comment on the current drafting which is proposed will be included in the next draft of the CP.

Practitioners Advisory Group

Extracts from CP Part 1: Sections 1 and 5

1. Background

- 1.1 The first draft of CP Part 1 was provided to TAG members on 24 March 2020, with a request for comments by 17 April 2020. PAG members were also provided with the first draft of CP Part 1 at that time but were not specifically requested to provide comment.
- 1.2 A wide range of feedback was provided by TAG members. These included high level comments and suggestions on the approach and structure of CP Part 1 and individual Sections. They also included more detailed comments on individual paragraphs, figures, and tables within each Section.
- 1.3 The initial analysis and proposed response to the high level comments and suggestions received was discussed with the TAG on 5 May 2020. Given the nature and number of comments it was agreed that two Sections of the CP would be redrafted and brought back to the TAG for comment at its 2 June 2020 meeting. These are the Sections that (i) define the scope of the entities which the Guidance will be developed for and (ii) that proposes a straw man model for developing the Guidance.
- 1.4 This paper provides PAG members with the two redrafted specific Sections.

2. Overview of changes made to "Section 1: What are Non-Profit Organisations?"

- 2.1 In their feedback on the draft of CP Part 1, a number of TAG members noted that the original document was difficult to read, was too long, that the language used was too technical, and that material included in the main document should be included in a preface.
- 2.2 In relation to Section 1, it was also noted that there needed to be a better explanation of which NPOs are most likely to benefit from the Guidance. It was indicated that this should include a justification for the focus on small and medium entities utilising accruals rather than receipts and payments and clarity over the non-mandatory nature of Guidance.

- 2.3 At the May TAG meeting, a draft of the Preface was presented which led to a reduction in the material that had previously been included as an introduction to “Section 1: What are Non-Profit Organisations?”.
- 2.4 In addition, to meet the other comments and suggestions raised by TAG members, a more direct approach has been taken to the Section with:
- a significant reduction in content, with some material proposed to be moved to a Supplementary Information section so that more detailed information about the approach is transparent;
 - use of less technical language to improve readability;
 - a clearer explanation of which entities the Guidance is primarily being developed for; and
 - more effective use of graphics.
- 2.5 This update of Section 1 was discussed with TAG members at the June meeting. Following this discussion some further minor amendments have been made and are included in Annex A for your input.

Question 1: What are the views of the PAG on the current draft of “Section 1: What are Non Profit Organisations?” that will be included in the next draft of CP Part 1.

3. Overview of changes made to “Section 5: A proposed way forward”

- 3.1 “Section 5: A proposed way forward”, was Section 6 in the draft previously shared with the PAG. Following feedback on this draft it was agreed with the TAG that Sections 2 and 3 would be combined because of duplication and hence the renumbering.
- 3.2 Comments from the TAG on the “Proposed way forward” in the first draft of CP Part 1 included a general view that it was too technical and would not be understandable to the audience of this part of the CP. Some TAG members also questioned whether a solution should be being proposed.

- 3.3 It was agreed at the May TAG meeting that changes needed to this Section included making clear that the model being proposed was a straw man to generate comment and support the overall approach of the CP. It was also noted that there should be an increased discussion on the levels of commonality of international and national guidance.
- 3.4 Changes made to this Section included:
- a significant reduction in content to improve readability and focus;
 - the use of less technical language where appropriate;
 - a clearer explanation that this is a straw man to generate comment, with a recognition that this is a credible way forward;
 - the more effective use of graphics;
 - a greater focus on the commonality of international and national guidance.
- 3.5 This update of Section 5 was discussed with TAG members at the June meeting and following this discussion some further minor amendments have been made. These are included in the draft in Annex B.

Question 2: What are the views of the PAG on the current draft of "Section 5: A proposed way forward" that will be included in the next draft of CP Part 1.

4. Remaining Sections

- 4.1 The remaining Sections of CP Part 1 will be redrafted in June and provided to TAG and PAG members for comment as part of the draft of the entire CP. A similar approach to reducing content, removing technical language, improving clarity, and making more effective use of graphics will be taken.
- 4.2 If the PAG has comments on other sections of the CP, please forward these to the PAG Secretariat. A summary of the TAG's comments are available on the project website, with the relevant papers noted in the covering page to this paper.

June 2020

Annex A

CONSULTATION PAPER PART 1: NON-PROFIT ORGANISATION ACCOUNTABILITY LANDSCAPE

Section 1: What are Non-Profit Organisations?

1.1. Objective 1 of the IFR4NPO project is:

To improve the quality and consistency of financial reports for NPOs that have accountability beyond the local community to stakeholders nationally or internationally.

In order to achieve this objective, it is necessary to define which entities are expected to be in scope of the Guidance. This Section proposes a broad characteristics approach to defining NPOs. It also examines which NPOs are expected to primarily benefit from the initial Guidance.

Broad characteristics approach to defining Non-Profit Organisations

1.2. The not-for-profit sector is characterised globally by the diversity of the types of organisations it includes. At one end of the spectrum are very small community bodies reliant on public donations and delivering services locally. At the other end are large international development organisations that provide a wide range of services across many countries and are funded by significant voluntary and commercial revenue streams. In between there are a whole host of different organisations, generating income from a number of sources and delivering a wide variety of services throughout society.¹

¹ Services incorporates not just human services like healthcare and physical services such as housing but a very broad range of activities which includes areas such as advocacy, scientific research, the provision of arts and culture, the promotion of occupational interests, and so forth.

1.3. As well as diversity in type of entity, the sector is also characterised by diversity in the legal and regulatory environments in which NPOs operate. In some jurisdictions, NPOs are formally recognised. They receive special legal and taxation status and may also be subject to NPO specific financial reporting guidance. In other jurisdictions no such recognition exists, with NPOs treated in a similar manner to profit oriented entities.

1.4. A number of academic studies and statistical guides have sought to develop international classification frameworks for NPOs by focussing primarily on the structural and operational features of entities. These are useful, but from a financial reporting perspective potentially exclude entities that would benefit from the Guidance and are less focussed on some important sector specific key economic events and transactions.

1.5. Given the diverse range of organisations, jurisdictions, and legal and regulatory frameworks that make up the NPO sector internationally, it is proposed to take a broad characteristics approach to defining NPOs. This approach utilises aspects of existing international classification frameworks, but places greater focus on the key economic events and transactions relevant to the not-for-profit sector.²

1.6. These key economic events and transactions are a major reason why there is a need for internationally applicable financial reporting guidance for NPOs. They include:

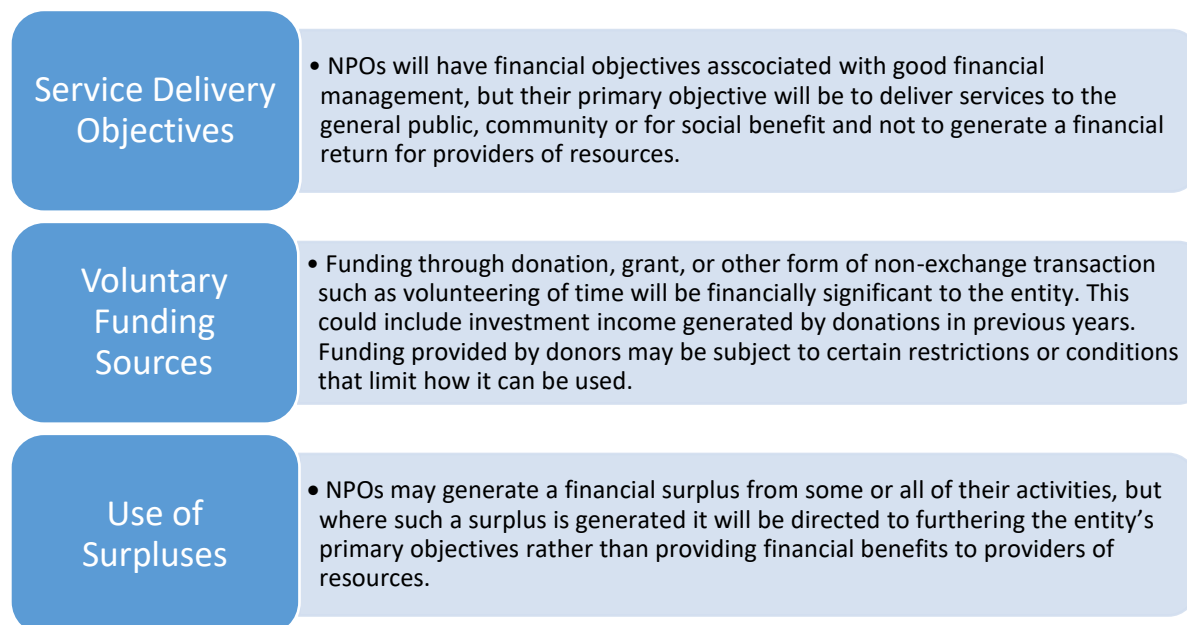
- The primary importance of objectives focused on **delivering services for public benefit**³;
- The prevalence of **assets used for social purposes** and not for economic returns;
- The significance of **voluntary donations and grant funding** and the need to demonstrate to providers of funding how this has been utilised; and
- How **profits/surpluses are directed for public benefit** rather than private purpose.

1.7. As shown in Figure 1.1 below, using these as a basis, the Guidance could be developed to apply to NPO entities that display the following broad characteristics:

² For examples of existing international classification frameworks and jurisdiction level approaches to defining NPOs for financial reporting guidance see Supplementary Information: Project Background and History.

³ Public benefit does not mean that the services provided by an entity must benefit all of the public. Depending on the nature of the services provided by the NPO a sufficient section of the public is generally sufficient. A local community organisation could for example restrict the services it provides to a particular small geographic area, or an entity that supports retired teachers could restrict services to just that group.

Figure 1.1: Broad characteristics of NPOs



1.8. While it is expected that an NPO would display all of these broad characteristics to a greater or lesser extent, the Guidance will not explicitly exclude entities that do not. Ultimately, the adoption of the Guidance will be subject to decisions by individual jurisdictions. These jurisdictions may deem aspects of the Guidance useful to entities accounting for similar economic events and transactions.

Who could the Guidance primarily benefit?

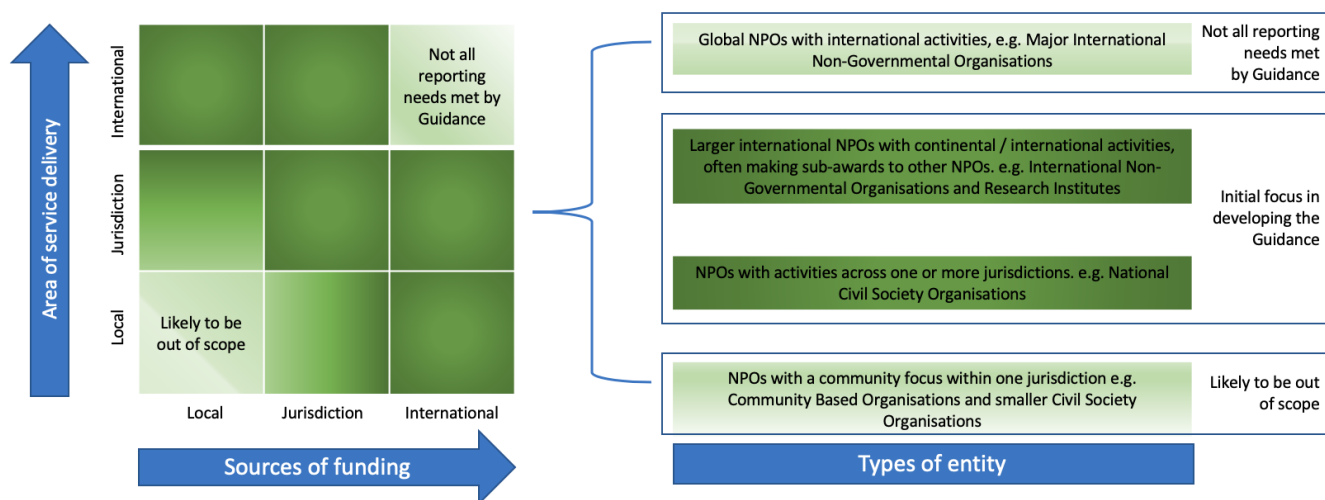
1.9. As already noted, NPO entities differ in type, activity, geographical coverage, size and complexity. As such, they do not all share the same financial management and reporting needs. The needs of smaller organisations may be much simpler than larger, more complex NPOs.

1.10. Service delivery and funding characteristics can bring additional complexity to financial management. NPOs can face significant burdens in complying with different funder and jurisdiction determined reporting requirements. It is these NPOs that could benefit most from internationally applicable guidance aimed at increasing the quality, consistency, transparency and reliability of financial reporting. The initial focus in developing the Guidance is therefore proposed to be on those NPOs:

- receiving large donations and grants from a number of funders at a jurisdiction and international level; and

- delivering services across an entire jurisdiction and/or in more than one jurisdiction.

Figure 1.2: Service delivery and funding characteristics of NPOs and examples of types of entity that the Guidance is being developed to benefit



1.11. Very small and less complex NPOs, who tend to have local funding sources and deliver services locally, comprise a significant part of the NPO community in many jurisdictions.⁴ These NPOs generally focus on ensuring that effective receipts and payments based financial management and reporting processes are in place. In this initial stage the Guidance is not aimed directly at the reporting needs of these organisations. A movement towards financial reporting based on internationally applicable guidance may benefit them over time. This will particularly be the case if they grow and look to attract new sources of funding and/or operate across an entire jurisdiction or in more than one jurisdiction.

1.12. In this initial stage the Guidance is not likely to meet all of the reporting needs of the major international NPOs. These NPOs have complex financial reporting requirements that are similar to many of the largest private sector organisations and national governments. While the Guidance will be of use to these entities, it is not initially expected to provide full financial reporting guidance relevant to all of the reporting issues they face. In areas not initially covered by the Guidance, it is expected that these

⁴ Differences in definitions used by jurisdictions make direct comparison difficult but around 60 percent of NPOs in New Zealand report using the most basic cash accounting tier that is reserved for entities with less than \$NZ 125,000 of operating expenses and just under 50 percent of UK charitable organisations have less than £10,000 per annum in income.

major international NPOs will have sufficient internal resources to be able to develop their own financial reporting solutions based on existing national and international standards.

Conclusion to Section 1: What are Non-Profit Organisations?

1.13. In Section 1 a broad characteristics approach has been developed to define NPOs. They are entities that have:

- the primary objective of delivering services to the general public, community or for social benefit;
- a significant source of their income derived from voluntary funding; and,
- any surpluses generated directed to furthering their primary service delivery objective.

1.14. It is proposed that Guidance will initially be developed to meet the needs of those NPOs that have more limited internal resources than perhaps the major international NPOs. These NPOs are nevertheless of a sufficient size and complexity that they have reporting requirements to funders and jurisdictions where current financial reporting arrangements do not provide adequate solutions. These are likely to be those NPOs that receive donations and grants or other income from jurisdiction level or international funders and also deliver services across an entire jurisdiction or in more than one jurisdiction.

1.15. In Section 2 we will examine further the problems with current accountability and decision-making arrangements for those NPOs that are the key focus for the IFR4NPO project, and the implications of this for the development of internationally applicable financial reporting guidance for NPOs.

General Matters for Comment 1

This section has demonstrated a broad characteristics approach to defining the NPOs that the Guidance will primarily be developed for:

1.1 Do you agree with the approach to defining NPOs? If not, why not? What alternative approaches would you propose, and why?

1.2 Do you agree with the characteristics proposed? If not, why not? Which alternative characteristics would you propose, and why?



1.3 Do you agree that the Guidance should initially be focussed on the needs of NPOs that are of a sufficient size and complexity that they have reporting requirements to funders and jurisdictions that current financial reporting arrangements do not adequately provide solutions to? If not, why not? What alternative approaches would you propose, and why? Who might be omitted or inappropriately included?

Annex B

Section 5: Proposed way forward

5.1. Section 4 looked at the key features needed of a financial reporting framework and the extent to which these already exist. Objectives three and four of the project, to address NPO sector specific issues and to deliver Guidance within a 5 year timeframe are key threads running through this section, and have been built into the assessment criteria.

5.2. Section 4 examined the options for utilising international frameworks to develop the Guidance. Using an existing international framework would enable the Guidance to harness a framework developed through a robust internationally accepted process. However, analysis of these frameworks against criteria linked to the objectives of the project demonstrated no single existing international framework performs well across all criteria.

5.3. It also highlighted the difficulties that would arise from developing the Guidance directly from a single jurisdiction's NPO standards. In particular it focused on the practicality of applying a single jurisdiction's standards internationally when each jurisdiction develops its standards primarily for its own local context. Section 5 therefore develops a way forward to meet the objectives of the IFR4NPO project through a bespoke model.

5.4. The design of the bespoke model reflects the preceding analysis of which NPOs the guidance should focus on, the accountability and decision-making arrangements prevalent in the sector and the issues that the guidance should address, how these arrangements could be strengthened, and the international frameworks and jurisdiction level standards that the Guidance can draw upon.

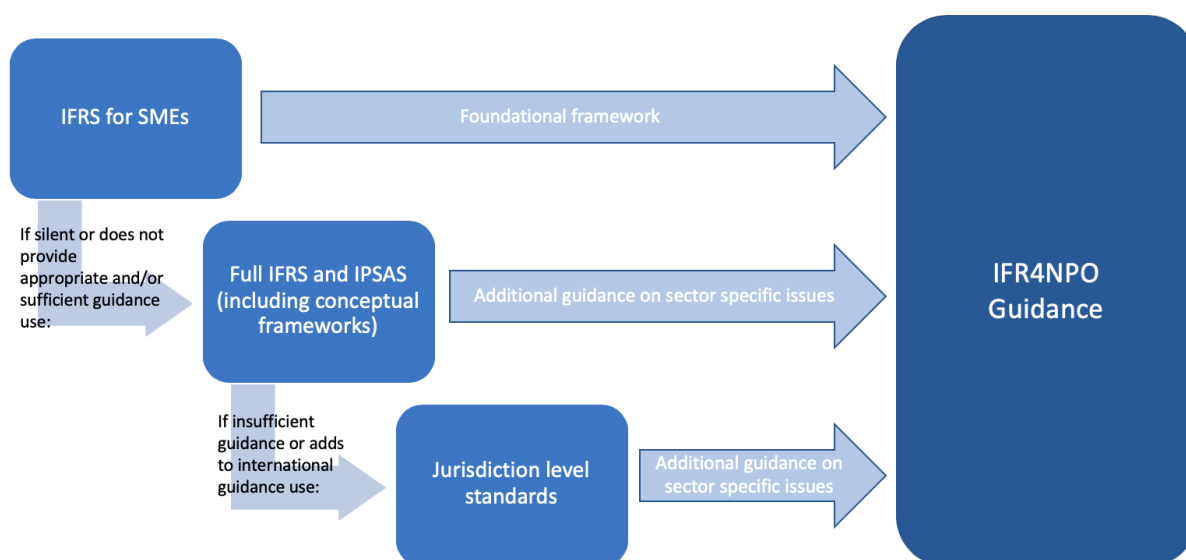
A bespoke model

5.5. As none of the international or national level frameworks provides an adequate standalone solution, a bespoke model where aspects of different frameworks are brought together to develop the Guidance is proposed.

5.6. IFRS for SMEs is proposed as the foundational international framework on the basis that it:

- provides a simplified standalone set of standards and reduced disclosure requirements in a number of areas compared with IPSAS or IFRS, that are expected, in most cases, to be more appropriate for the NPO context;
- is aligned with the full IFRS conceptual framework and due process;
- is expected to have relatively higher familiarity and acceptance amongst regulators, preparers, auditors and users internationally; and
- is the most feasible solution as it would require the lowest level of initial and ongoing resource to develop and maintain the Guidance.

Figure 5.1: Bespoke model



5.7. Where IFRS for SMEs is silent on NPO sector specific reporting issues or does not otherwise provide appropriate and/or sufficient guidance, the model would draw on full IPSAS, IFRS, and their broader conceptual frameworks to develop sector specific reporting solutions. IPSAS may be particularly useful in relation to those transactions that are for social benefit rather than for profit.

5.8. The model would also draw on jurisdiction level standards, particularly where they have been developed in a manner that is sufficiently consistent with the conceptual basis of IFRS and/or IPSAS. Jurisdiction level standards provide interpretations or guidance based variously on IFRS for SMEs, IPSAS and IFRS as well as specific standards and/or guidance based on local GAAP. These may be useful in developing the Guidance, where local interpretations add to international guidance or where there is no content in international frameworks. This approach may also be particularly useful in considering

NPO specific disclosure requirements, which are likely to differ from those for the private and public sectors.

Assessing the model against the criteria

5.9. In Section 4 the international frameworks were assessed against three criteria. The same criteria have been used to assess the proposed bespoke model:

Figure 5.2: Comparing use of a single international framework against the bespoke model

Single international framework	Bespoke model
<i>Does the framework provide guidance on the most prevalent sector specific issues?</i>	
No single international framework provides guidance on all the sector specific issues identified, although IPSAS is stronger in areas where transactions are for social benefit rather than for profit.	Inclusion of IFRS, IPSAS and jurisdiction level standards allows the model to utilise the standards from different conceptually similar frameworks to provide guidance to sector specific issues.
<i>Will preparers, auditors and users be familiar with and easily able to use the framework?</i>	
Familiarity with full IFRS and IPSAS in the NPO sector will be limited, and these are complex standards with extensive disclosure requirements. Potential for IFRS for SMEs to be more familiar if it has been incorporated into local GAAP and the framework is designed to be easier to use.	By using frameworks that share a conceptually similar basis, familiarity will be increased. Omitting irrelevant accounting topics for NPOs and sector appropriate reductions in accounting options and disclosure requirements will also support ease of use.
<i>How feasible will the development and maintenance of Guidance under the framework be?</i>	
Complexity and frequency of change of full IFRS and IPSAS would necessitate a significant amount of initial work and a process of monitoring for the interpretation and adaption of standards for the NPO context. IFRS for SMEs is a simplified framework and subject to more limited revision so initial and ongoing resource to develop and maintain the Guidance would be reduced.	Utilising IFRS for SMEs as the foundational framework is expected to limit the initial and ongoing resource required to develop and maintain the Guidance. Where IFRS, IPSAS and jurisdiction level standards are used, timing differences and changes to these frameworks will need to be monitored to ensure material inconsistencies do not develop.

5.10. The bespoke model performs better overall against the criteria than any individual international framework as it:

- ensures that the Guidance covers the most prevalent sector specific issues when no single international framework can;

- maximises familiarity and ease of use of the Guidance by using frameworks with a shared conceptual basis and having a foundation of sector appropriate reductions in accounting options and disclosures; and
- limits the initial and ongoing resource needed for the Guidance to be developed and maintained.

5.11. There are two potential issues that can be raised with the bespoke model; conceptual coherence and dealing with timing differences between framework updates. On conceptual coherence there are differences between the objectives of financial reporting on which IFRS and IPSAS are based, but in most respects they are very similar. Aspects such as the reporting entity, what comprises useful information, what financial statements should include, and how assets and liabilities can be measured are largely consistent between the two frameworks. The same is true of jurisdiction level financial reporting frameworks that have been developed in a manner consistent with the conceptual basis of IFRS and IPSAS. The similarities will support conceptual coherence.

5.12. On timing differences the international frameworks and jurisdiction level standards are all subject to different standard setting due process. This means that even where there is agreement that standards need revision, some frameworks and jurisdiction level standards will not be updated at the same time as others. In the bespoke model proposed, the presumption will be that the requirements of IFRS for SMEs will be followed to provide a stable foundation. Where another framework has, however, been used to provide a sector specific solution then any updates to the underlying standard could be used for that specific aspect of the Guidance.

Conclusion to Section 5: A proposed way forward

5.13. In Section 5, a bespoke model has been proposed to generate a 'straw man' for comment. This bespoke model performs better overall against the three criteria used to assess the international frameworks than any one individual framework.

5.14. The bespoke model proposes IFRS for SMEs as its foundational framework. Where IFRS for SMEs is silent on NPO sector specific reporting issues or does not otherwise provide appropriate and/or sufficient guidance, the model proposes to draw on full IFRS, IPSAS, and their broader conceptual frameworks to develop sector specific reporting solutions. The model also proposes to draw on jurisdiction level standards, particularly where they have been developed in a manner that is deemed sufficiently consistent with the conceptual basis of IFRS and/or IPSAS.

5.15. International financial reporting guidance for NPOs has the potential to significantly improve the quality, transparency, consistency and comparability of NPO financial reports. Significant improvements can be made by drawing on good work from around the globe. The bespoke model proposed provides a credible option for developing Guidance that will meet the IFR4NPO projects objectives of:

- improving the quality and consistency of financial reports;
- improving the transparency and comparability of financial reports;
- supporting the provision of decision useful information whilst balancing the needs of preparers and funders; and
- being deliverable within a five year timeframe.

General Matters for Comment 5

This Section has proposes a 'straw man' for developing the Guidance. This NPO bespoke model proposes IFRS for SMEs as a foundational framework and also full IFRS, IPSAS and jurisdiction level standards to develop the Guidance.

5.1 Do you agree that a bespoke model should be considered as a means of developing the Guidance? If not why not and how would you overcome the disadvantages of using a single framework?

5.2 Do you agree with the model proposed? If not why not and what alternative model do you propose would be more suitable (if any) and why?

5.3 Do you have any concerns in using IFRS for SMEs as the foundation? If so, what are they?

5.4 Do you agree with the assessment of the model against the criteria? If not, why not and how would you assess the model?