

Technical Advisory Group

Issue Paper

AGENDA ITEM: TAGED04-05
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Broad characteristics and the primary users of NPO GPFs and their information needs - Update

Summary	This paper provides an overview of the additional work that has been undertaken to refine the broad characteristics approach and identify the primary users of NPO GPFs and their information needs.
Purpose/Objective of the paper	To allow TAG members to comment on the update to the approach and the Secretariat's initial view as to how this will be introduced into the 'landscape' Section of the International Non-Profit Accounting Guidance (INPAG) for the Exposure Draft.
Other supporting items	TAGED03 01 - <i>Analysis of responses to Consultation Paper Part 1 and initial proposals for formal response and changes to approach</i>
Prepared by	Philip Trotter
Actions for this meeting	Comment on the update to the approach and the proposal for how this will be introduced into the 'landscape' Section of INPAG for the Exposure Draft.

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Broad characteristics and the primary users of NPO GPFRs and their information needs - Update

1. Background

- 1.1 In TAGED 03 01 *Analysis of responses to Consultation Paper Part 1 and initial proposals for formal response and changes to approach* a detailed analysis of responses to Part 1 of the Consultation Paper was provided to the TAG. The paper focussed on key themes that had emerged from the review. It also provided an initial view on how the Secretariat intends to formally respond to the issues raised by respondents, and initial proposals for any changes to approach that are being recommended for the Exposure Draft.
- 1.2 Areas where additional work in advance of this meeting were proposed included the broad characteristics approach and identifying the primary users of NPO GPFRs and their information needs. This was deemed necessary due to the views of some respondents that:
- There was a possibility of unintended consequences with respect to scope due to the and/or nature of the broad characteristics;
 - It wasn't clear whether all of the broad characteristics were characteristics in their own right, or should more appropriately be seen as indicators of other characteristics or consequential to activities driven by them; and
 - It was necessary to directly articulate who the primary users of NPO GPFRs are and the information they need for accountability and decision-making purposes.
- 1.3 Discussion at TAGED 03 supported the need for additional work in these areas, with TAG members providing suggestions as to how the approach could be updated. Based on the feedback obtained from the TAG, the IFR4NPO Secretariat has updated the approach to these areas, and also developed proposals for how these can be introduced into the 'landscape' sections of the Exposure Draft.
- 1.4 PAG members were provided with an overview of the proposed changes to the broad characteristics approach and proposals for who the primary users of NPO

GPFRs are at their meeting on 15 November 2021. Where relevant their views on these changes have been noted in the relevant sections.

2. Broad characteristics approach

- 2.1 Based on the feedback obtained from respondents, it was proposed that to support the development of the Exposure Draft the IFR4NPO Secretariat would:
- (i) look at (re)defining some key terms that have caused confusion such as public benefit;
 - (ii) amend the broad characteristics to take into consideration issues raised including ensuring the inclusion of entities that provide goods or grant financing; and
 - (iii) potentially change the number of broad characteristics and examine how to provide additional guidance through indicators and other explanatory text in areas like the receipt and provision of funding and the use of assets.
- 2.2 Discussion with TAG members supported work in these areas. There was a general consensus that the broad characteristics needed to err on the side of being expansive. This was necessary given global diversity and the fact that ultimately it will be individual jurisdictions that will determine which entities apply the International Non-Profit Accounting Guidance (INPAG), with the information needs of users being paramount.
- 2.3 The IFR4NPO Secretariat has, therefore, looked again at the broad characteristics and proposes the changes noted below be made for the Exposure Draft.
- 2.4 It is expected that the broad characteristics approach and related explanatory text will be included in Section 1 of the INPAG. This will replace Section 1 – Small and Medium-sized Entities within the *IFRS for SMEs* Standard with Section 1 – Non-profit organisations.

Intended scope

- 2.5 It is proposed that Section 1 of the Exposure Draft will note that the INPAG is intended for use by Non-profit organisations but that decisions on which entities are required or permitted to use the INPAG will rest with individual jurisdictions. These jurisdictions may require or permit the application of aspects of the INPAG to entities that are not its primary focus, including those that are

government controlled or more broadly within the public sector, where they deem it appropriate.

- 2.6 The Section will note that the description of the broad characteristics and other indicators will assist individual jurisdictions in determining whether the INPAG will be suitable for meeting the information needs of users of GPFs of these entities in their jurisdictions.

Broad characteristics

- 2.7 It is proposed that the number of broad characteristics be reduced to two, and that entities would be expected to demonstrate both broad characteristics to be described as NPOs. NPOs will be described as entities that are not controlled by government that have:
- The primary objective of providing goods and/or services for public benefit; and
 - Direct profits or surpluses for public benefit.
- 2.8 For the first broad characteristic, it is proposed that the explanatory text in Section 1 notes that the primary objective of an NPO will be to provide goods and/or services to the general public, community or for wider societal benefit and not to generate a private benefit for providers of resources.
- 2.9 The text will note the diversity of the goods and services provided by NPOs. It will note that what is common to all of these goods and services, is that they benefit the public in general, or at least a sufficient section of the public, and do not give rise to private benefits such as financial returns to those providing resources to the entity.
- 2.10 The explanatory text will also note that depending on the goods and services provided by the entity, the 'sufficient section of the public' could be quite limited. It may even be restricted to a defined membership of the entity. This will not preclude an entity from being described as an NPO, but where the section of the public benefitting from the goods and services provided by the NPO is limited in this way, then it is likely that further consideration of other wider indicators would be needed to determine if the entity is an NPO.
- 2.11 For the second broad characteristic, the explanatory text will note that NPOs may generate a financial surplus from their activities, particularly where they receive income from the sale of goods and services or have significant financial assets. Where this is the case, these financial surpluses will be directed to

furthering the entity's primary public benefit objectives and should not be distributed for private benefit to providers of resources to the entity.

- 2.12 The text will note that while distributing financial returns to equity holders through dividends would be a relatively clear indication that an entity is unlikely to be an NPO, there are other benefits that an NPO can provide that would also require further consideration. These include, for example, if a membership entity were to provide discounted goods and services to its members, or if it were to offer a rebate to members based on the volume of goods or services they had purchased.
- 2.13 PAG members were supportive of these proposals. Discussion was held over as to whether this would potentially scope out entities currently deemed to be NPOs under existing regulations in some jurisdictions. It was agreed, however, that the definition of public benefit should be broad enough to enable jurisdictions to apply this to their own circumstances.

Other indicators

- 2.14 In a change to the proposals in the Consultation Paper and as a result of the feedback obtained from respondents and the TAG, it is proposed that "other indicators" are also introduced. Where it is not clear if an entity fully displays the broad characteristics of NPO, these other indicators can be used to assist in determining whether the entity is within the intended scope of applicability of the INPAG.
- 2.15 Two of these indicators were originally included as broad characteristics in the Consultation Paper, while a third is new and draws on feedback obtained from respondents and the TAG and an additional review of jurisdictional-level approaches. The other indicators are:
- Rights to financial returns and transfer of residual net assets upon dissolution;
 - Voluntary funding; and
 - Purpose and use of assets.
- 2.16 Rights to financial returns and transfer of residual net assets upon dissolution has been discussed previously but is new for the purposes of the INPAG. The indicator will note that where an entity has been established primarily to generate a financial return for the benefit of holders of equity, the nature of the ownership interest including ongoing rights to financial returns and net assets in the event of the dissolution of the entity is usually clearly defined. An indicator

that an entity is likely to be an NPO includes an absence of individuals having such rights and a requirement that upon dissolution of the entity any residual net assets have to be transferred to an entity with a similar purpose.

- 2.17 Voluntary funding was previously a broad characteristic but is now proposed as an indicator and has been amended to recognise feedback related to grant-giving organisations. The indicator will note that for many NPOs, the provision and receipt of voluntary funding through donations, grants or volunteering of services may be significant to the entity. The provision of such funding will not be compulsory, as is the case with taxation, and the provider may impose restrictions or conditions that limit how it can be used. Such resources and restrictions on use should not, however, entitle the provider to financial or other economic returns.
- 2.18 Finally purpose and use of assets also used to be a broad characteristic but is now proposed as an “other indicator” and also has been amended to reflect feedback from respondents. The indicator will note that NPOs may control or have access to assets such as buildings or equipment that are used as part of their operations. They may also have a responsibility for the preservation and enhancement of assets such as artistic works, heritage assets, and natural assets. Where this is the case these assets will be held primarily to assist in delivering goods and/or services for public benefit and not to generate financial returns to providers of resources.
- 2.19 PAG members were supportive of these proposals. Discussion highlighted that the new other indicator on rights to financial returns and transfer of residual net assets upon dissolution in particular was likely to be useful in those cases where it may not be clear if the two broad characteristics were both met.

Uncertainty around whether an entity displays the broad characteristics and other indicators

- 2.20 Section 1 will also note that in some circumstances it may not be clear if the broad characteristics and other indicators describe an entity as an NPO or not. For example an entity may deliver goods and services for public benefit and direct the majority of profits to furthering its public benefit objectives but there may be a small equity interest which does attract a level of ongoing private financial return.
- 2.21 The Section will indicate that where this is the case jurisdictions will need to use their own professional judgement in deciding whether the entity is one to which the INPAG is intended for use or not.

Question 1: What are the TAG's views on the proposals for (a) the intended scope of the INPAG, (b) the changes to the broad characteristics and the introduction of other indicators (including how "not controlled by government" has been introduced into the description of NPOs), and (c) how these are expected to be included in the text of the INPAG?

3. Primary users of NPOs GPFs and their information needs

- 3.1 Based on the feedback obtained from respondents, it was proposed that to support the formal response and the development of the Exposure Draft the IFR4NPO Secretariat would:
- (i) Re-examine the key stakeholders to integrate 'internal' stakeholders and other similar groups where appropriate;
 - (ii) Determine who the primary users of NPO GPFs; and
 - (iii) Articulate the financial and non-financial information needs of these primary users specifically with reference to GPFs.
- 3.2 Discussion with TAG members supported work in these areas. There was a general consensus that although a non-executive board or similar body charged with oversight could be seen as an 'internal' stakeholder that might be a primary user, members were uncomfortable with extending this to other internal stakeholders such as staff. There was also discussion as to the extent to which regulators might be primary users, particularly as they were usually in a position to demand information on their own terms outside of what would generally be seen as GPFs.
- 3.3 The IFR4NPO Secretariat has examined these areas and proposes the approach noted below for the Exposure Draft. It is expected that information on who the primary users of an NPOs GPFs are and their financial and non-financial information needs will be included within Section 2 of the INPAG. This will be a significantly modified Section 2 - *Concepts and Pervasive Principles* from the *IFRS for SMEs* Standard.
- 3.4 It is proposed that the modified Section 2 will describe the objectives of financial reporting of Non-profit organisations, the users of NPO GPFs and their information needs, the qualities that make the information in GPFs useful to users and support the achievement of the objectives of financial reporting, and

the concepts and basic principles underlying the financial statements including elements, measurement and presentation.

Primary users of GPFRs

- 3.5 The objectives of financial reporting by NPOs are to provide information about the entity that is useful to users of GPFRs for accountability and decision-making purposes. As highlighted above, NPOs are entities that provide goods and services for the public benefit, and direct financial surpluses to furthering their public benefit objectives.
- 3.6 This description of NPOs highlights that NPOs are accountable for their management and use of resources to those that provide them with resources, and to those that depend on them to use those resources to provide goods and services. It is proposed by the Secretariat that this would indicate that primary users of NPO GPFRs include resource providers and the public to whom the NPO provides goods and services.
- 3.7 The interests of resource providers and the public to whom the NPO provides goods and services are often upheld by groups fulfilling non-executive oversight functions. As discussed at the previous TAG, for NPOs this can include non-executive boards responsible for challenging and holding the executive of an NPO to account. It can also include public officials or elected representatives who protect the interests of those to whom they have a duty of care and/or their constituents.
- 3.8 The conceptual bases of international frameworks for general purpose financial reporting define primary users as those that do not possess the authority to require an entity to disclose the information they need. In the case of NPOs, groups fulfilling non-executive oversight functions such as non-executive boards may have the authority to require such information but potentially not the expertise or capacity to use it effectively.
- 3.9 This was discussed with the PAG and it was noted that there may therefore be a case for the inclusion of terms such as expertise and capacity as well as authority when discussing whether primary users are able to require NPOs to disclose information.
- 3.10 If this were accepted it could expand primary users to include groups fulfilling non-executive oversight functions such as non-executive boards. It would mean that the GPFRs of NPOs should be developed primarily to respond to the information needs of the public to whom the NPO provides goods and services,

resource providers, and those fulfilling non-executive oversight functions on their behalf, who do not possess the authority to require an NPO to disclose the information they need for accountability and decision-making purposes or who lack the expertise or capacity to do so.

- 3.11 The position of donors and regulatory bodies was also discussed with the PAG. Donors and regulatory bodies such as tax authorities are likely to have the authority to require the preparation of financial reports tailored to meet their own specific information needs. At the same time as being able to require specific financial reports, donors and regulatory bodies may find the information provided by GPFs useful and utilise it for their own purposes.
- 3.12 The Secretariat's view is that GPFs are not developed specifically to respond to any donor or regulatory bodies particular individual information needs, which as noted they may have the authority to require an NPO disclose as a special purpose financial report. Donors and regulatory bodies in the Secretariat's view may, however, be primary users of GPFs when they are general users of financial statements, for example in carrying out due diligence activities. In these situations they will be acting like other resource providers or providers of oversight. This position was supported by the PAG.
- 3.13 The Secretariat also agrees with the PAG view that it is important that the position of donors as users of the GPFs is well described, and will develop text for inclusion in the Exposure Draft to ensure this and that the views of the PAG are reflected.

Question 2: What are the TAG's views on the determination of:
(a) resource providers and the public to whom the NPO provides goods and services as the primary users of NPO GPFs are;
(b) the inclusion of "or who lack the expertise or capacity to do so" in addition to "do not possess the authority to require an NPO to disclose the information they need for accountability and decision-making purposes" which would potentially lead to the inclusion of groups fulfilling non-executive oversight functions such as non-executive boards as primary users;
(c) the Secretariat's view on the position of donors and regulatory bodies as primary users in the context noted?

- 3.14 The financial and non-financial information needs of primary users need to be articulated based on the information these users need for accountability and decision-making purposes and the information provided by GPFs to meet these needs.

- 3.15 The Secretariat provides an initial view of the financial and non-financial information needs of primary users to support accountability and decision-making purposes below. This will be further developed following this meeting to reflect the views of the TAG and is expected to be included in Section 2 of the INPAG.

Accountability and decision-making and information needs of primary users of GPFs

- 3.16 The Consultation Paper noted that accountability arises when decisions and actions are undertaken by those in a position of responsibility. Accountability entails accepting responsibility for those decisions and actions, together with a requirement to explain them to stakeholders. Those to whom an entity is accountable will then make decisions based on the information provided to them.
- 3.17 For an NPO there will be a wide range of areas in which accountability arises. These may include for example the provision of goods and services of sufficient quality and quantity to deliver public benefit outcomes. The NPO will also be accountable for compliance with regulations that govern the goods and services that it can provide, and compliance with restrictions imposed on the use of funding provided to the entity to deliver those goods and services. The NPO will be accountable for the stewardship of financial, physical and natural assets that the entity has ownership or control over and responsibility for. More broadly it will also be accountable for ensuring that its activities, the actions and behaviours of its staff and volunteers, and others that it has relationships with such as providers or resources, suppliers and other entities it delivers goods and services with are supportive of the wider public good.
- 3.18 The discharge of accountability obligations requires the provision of information about these areas. This enables stakeholders to make decisions such as whether to provide resources to support the current and future activities of the NPO, to lobby the entity or public officials regarding the goods and services provided by the NPO and to whom, or to maintain or withdraw any legal or regulatory privileges that govern the NPOs activities and operations.
- 3.19 GPFs are a key way in which entities can provide information to support the discharge of accountability obligations. As noted above they should be prepared primarily to respond to the information needs of users who do not possess the authority to require an NPO to disclose the information they need for

accountability and decision-making purposes (and potentially also those who lack the expertise or capacity to do so).

- 3.20 The primary users of NPO GPFs will need some information that is common to the primary users of GPFs in the public and private sectors. This will include information about the financial performance of the entity during the reporting period, the liquidity and solvency of the entity, the sustainability of its operations over the long term, and changes therein as a result of the activities of the entity during the reporting period.
- 3.21 The GPFs will therefore need to provide information about the financial position, financial performance and cash flows of the NPO to enable users to identify the resources available to the NPO and claims on them at the reporting date.
- 3.22 The funding sources, legal and regulatory position, and nature of the goods and services provided by NPOs, however, does lead to information requirements that differ in some ways from the private and public sectors.
- 3.23 For example, compared to the private sector where individuals are usually free to determine whether or not to purchase the goods and services provided by the entity, the public to whom the NPO provides goods and services may often have little discretion to choose whether or not to accept the goods and services provided by the NPO or choose an alternative provider. As such information on the volume and quantity of goods and services provided during the reporting period and the extent to which resources are available to support the provision of goods and services in future periods will likely be of greater importance than in the private sector.
- 3.24 Also unlike in the public sector where entities are usually funded by compulsory taxation which is not hypothecated to individual activities, many NPOs rely on voluntary funding which is subject to restrictions as to the activities it can be used for by the provider. As such information will be needed to demonstrate that resources have been spent to deliver specific goods or services, and that any allocation of funds to contribute to general overheads, fundraising or similar activities is appropriate.
- 3.25 Other areas where the information the primary users of NPO GPFs need for accountability and decision-making purposes may differ in importance from the private and/or public sector include the manner in which the entity has directed any surpluses to the achievement of public benefit objectives, and the stewardship and use of assets that the entity owns and/or controls and has responsibility for.

Information that will need to be provided by NPO GPFs to meet the needs of users

- 3.26 In order to meet the information needs of users, NPO GPFs will need to provide core financial information about the financial position, financial performance and cash flows of the NPO. This will enable users to identify the resources available to the NPO and claims on them at the reporting date. It will also assist users in understanding the extent to which the NPO has acquired resources economically, and used them effectively in a way that optimises efficiency to achieve its provision of goods and services objectives, while supporting the NPO's liquidity and solvency.
- 3.27 This core of financial information presented in the financial statements is unlikely to be sufficient to meet the information needs of users discussed above. It will need to be supported by financial and non-financial information in the GPFs that enhances, complements and supplements the core financial information.
- 3.28 This will include information about such matters as the NPOs:
- Compliance with regulations governing its operations, including restrictions placed by resource providers on the use of funding;
 - Goods and services activities and achievements during the reporting period; and
 - Expectations regarding goods and services delivery and other activities in future periods, and the long term consequences of decisions made and activities undertaken during the reporting period, including those that may impact expectations about the future.
- 3.29 The specific content and format of the financial statements and the wider financial and non-financial information required to meet the information needs of users of NPO GPFs will be further explored and defined through Issue 1: Reporting entity, Issue 7: Presentation of financial statements and Issue 10: Narrative reporting.

Question 3: What are the TAG's views on the articulation of accountability and decision-making, and the information needs of primary users with reference to the GPFs?



4. Next Steps

- 4.1 Subject to the feedback received from the TAG, these proposals will be further developed for the Exposure Draft and presented to the TAG at its next meeting in April 2022.

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