

Technical Advisory Group

Issue Paper

AGENDA ITEM: TAGED07-01

28 June 2022 – Online

Section 2 - Concepts and Pervasive Principles update

Summary	This paper updates the TAG on proposals for revisions to INPAG Section 2 Concepts and Pervasive Principles as a result of the advice and requests received at the April and May 2022 meetings.
Purpose/Objective of the paper	<p>To provide the TAG with proposals for the direction of travel on a number of technical areas for INPAG Section 2 Concepts and Pervasive Principles and to gain feedback on these proposals.</p> <p>Detailed drafting of the text of these proposals will be undertaken following receipt of the Exposure Draft of the revised IFRS for SMEs Standard and subject to advice and requests received from the TAG.</p>
Other supporting items	N/A
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Actions for this meeting	<p>For the TAG to provide advice on:</p> <ul style="list-style-type: none">• The proposed direction of travel for a number of technical areas on which the TAG has previously provided advice and requests.

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Section 2 - Concepts and Pervasive Principles update

1. Background

- 1.1 The TAG were provided with an overview of the emerging technical issues associated with Section 2 – Concepts and Pervasive Principles of the INPAG that will form part of Exposure Draft 1 at its April 2022 and May 2022 meetings. At these meetings the TAG provided advice and requests to the Secretariat in relation to these emerging technical issues.
- 1.2 Section 2 Concepts and Pervasive Principles is derived, in accordance with the 'Rules of the Road', from the IFRS for SMEs Standard. The IFRS for SMEs Standard is currently subject to comprehensive review. A detailed revision of the draft text for INPAG Section 2 will not be undertaken until a draft of the IFRS for SMEs Exposure Draft is available. There are, however, a number of areas where based on the advice of the TAG, a direction of travel can be determined.

2. Technical issues and proposed direction of travel

- 2.1 The most significant technical issues on which advice and requests were provided by TAG and the proposed direction of travel are noted below.

Inclusion of financial statements in concepts and pervasive principles

- 2.2 The TAG noted that the inclusion of financial statements in INPAG Section 2 may not be needed at the conceptual level and could instead be dealt with in the relevant subsequent Sections.
- 2.3 In the current structure of Section 2 of the IFRS for SMEs Standard, elements are largely defined based on the financial statements to which they relate. The IASB Conceptual Framework does not take this approach, instead defining the elements independently of the financial statements. Along with other alignment proposals to the IFRS for SMEs Standard, the revised Standard is likely to take an approach that is more aligned to the IASB Conceptual Framework.
- 2.4 There is no NPO specific reason for including financial statements in Section 2 so it is proposed that reference to the financial statements will only be retained to the extent that this is the approach of the revised IFRS for SMEs Standard. The

majority of the core content related to the financial statements will be covered in subsequent Sections.

Question 1: Does the TAG agree with the proposals to only retain reference to the financial statements in the definition of the elements to the extent that this is the approach in the revised IFRS for SMEs Standard?

Presentation

- 2.5 The TAG recognised the importance of providing content for NPOs on the presentation of information in GPFRs but were not clear that this should be included as part of concepts and pervasive principles. Instead, it was suggested that this could be included in another Section.
- 2.6 Guidance on presentation will be useful for preparers of NPO GPFRs. While it is not currently included in Section 2 of the IFRS for SMEs Standard, both the IASB Conceptual Framework and the IPSASB Conceptual Framework do include content related to the presentation of information in financial statements and GPFRs.
- 2.7 It is proposed that text on concepts related to presentation will be retained in Section 2 of the INPAG, although this may be amended to reflect any concepts and principles on presentation included in the revised IFRS for SMEs Standard.

Question 2: Does the TAG agree with the proposal for retaining concepts related to presentation in Section 2, subject to presentation concepts and principles included in the revised IFRS for SMEs Standard?

Additional text on users of NPO GPFRs

- 2.8 The TAG noted that text could be brought from the Basis for Conclusions into the core guidance to provide additional detail and clarity on the users of NPO GPFRs.
- 2.9 The primary users of NPO GPFRs are noted in the core guidance, along with text indicating that GPFRs are not developed specifically to respond to any individual information needs. The core guidance also notes that NPOs may have users of their GPFRs that can be primary users in some circumstances but in others have the rights to tailored information.
- 2.10 The overarching principle on content inclusion in the INPAG is to mirror the IFRS for SMEs Standard, where the core guidance contains only essential text for the preparation of the GPFR. Additional authoritative and non-authoritative guidance

is provided where necessary through Application Guidance, Implementation Guidance and Examples, and the Basis for Conclusions.

- 2.11 The Basis for Conclusions in particular aims to explain the process by which technical issues have been considered to develop the guidance in the INPAG rather than providing additional guidance. It is proposed therefore that the text included in the Basis for Conclusions related to users will not be included in the core guidance, as it has a different aim to the core guidance and is not essential authoritative text.

Question 3: Does the TAG agree with the rationale for the additional text being retained in the Basis for Conclusions?

Reporting NPO

- 2.12 The TAG raised a number of issues in relation to the Reporting NPO. Some of these related to the placement of text either in the core guidance or Application Guidance, and whether additional guidance, descriptions or examples were needed in areas such as control and branches. As noted above in relation to users, the overarching principle is to include only essential text within the core guidance. In the specific areas raised by the TAG relating to the application of control principles and defining and providing indicators or characteristics of branches, it is proposed that additional text will be included in the Application Guidance and Implementation Guidance.
- 2.13 Comments were also raised regarding the two-fold approach to identifying a reporting entity. This included the view that the first element appeared to just repeat part of the broad characteristics of NPOs, and that clarification was needed as to whether the two-fold approach was a two-step process.
- 2.14 The two-fold approach does bring some additional clarity where there is uncertainty as to the existence of a reporting NPO and did have support in the focus group held on this subject. It is derived from the IPSASB Conceptual Framework where it is used to assist in determining if there is a public sector reporting entity where the public sector context may make identifying the reporting entity more challenging.
- 2.15 It is recognised, however, that the first characteristic of the two-fold approach is effectively covered as part of the description of an NPO in Section 1. There, the broad characteristics of an NPO indicate that the entity will have a primary objective of providing a benefit to the public, and to do so it will need resources to

deliver goods and services. It is also clear that that if there are primary users with information needs that are effectively determining the reporting boundary of a reporting NPO, then the second step will be met.

- 2.16 As the two-fold approach did have support from participants in the focus group there may be benefit to preparers from including a stepped process in the literature. Given the views put forward, it is proposed, that the two-fold approach is not included in the core guidance, but is appropriately included in the Application Guidance.

Question 4: Does the TAG agree with the proposal to move the text on the two-fold approach to the Application Guidance, where it will provide additional authoritative text to support preparers in identifying whether a reporting NPO exists?

Definition of expenses element

- 2.17 The TAG noted that a definition of expenses that includes losses may not be intuitive and that this could potentially be addressed by defining loss as a separate element.
- 2.18 The IFRS for SMEs Standard currently defines expenses to include losses. The proposed definition for inclusion in the INPAG text follows this definition. Following the comprehensive review of the IFRS for SMEs Standard this definition could change.
- 2.19 It is proposed to re-examine this element once the draft Exposure Draft text of the IFRS for SMEs Standard is available. The principle that most unrealised losses (and gains) will be recognised in a Statement change in net assets and not in the Statement of income and expenses or an OCI will be retained. This is in line with the proposals for the financial statement presentation, to be considered in a separate paper.

Question 5: Does the TAG agree with the proposal to re-examine the expenses element against any updated definition in the revised IFRS for SMEs Standard?

Net assets element

- 2.20 The TAG raised a number of points on the element that was defined as net assets. These included:

- (a) that the term net assets may be viewed as a mathematical formula rather than as an element;
- (b) that the relationship between net assets and equity in the text wasn't clear; and
- (c) that restricted and unrestricted funds needed to be examined in terms of enforceable restrictions and that this would need to be very clearly articulated.

In these discussions, the TAG noted that useful guidance on defining the element could potentially be found through examining the IPSASB Conceptual Framework and the IPSASB's recent discussions on obligations from the Revenue Standards Exposure Drafts.

- 2.21 The IPSASB Conceptual Framework uses the term net financial position to indicate the residual amount of an entity, which reflects the possibility of other resources and other obligations as well as net assets. Net financial position is though not used in any individual IPSAS standard with the term net assets/equity preferred. Net financial position is also not defined as an element. Instead, the IPSASB in addition to assets, liabilities, revenue and expenses has the elements of 'ownership contributions' and 'ownership distributions'. These are related to 'an interest in the net financial position of the entity' and reflect that inflows and outflows of resources to an entity from owners related to their interest in the entity that are not revenue or expenses.
- 2.22 It is proposed that net assets is not retained as an element. However, an additional element that represents 'equity' but is appropriate in the NPO context is required in Section 2 of the INPAG. The proposal is to adapt the approach in the IPSASB Conceptual Framework so that the elements of capital contributions and capital distributions will be introduced into the INPAG.
- 2.23 Capital contributions will be defined as 'an inflow of resources to the NPO, contributed by parties external to the NPO, which establish or increase a financial interest in the net assets of the NPO'.
- 2.24 Capital distributions will be defined as 'outflows of resources from the NPO, distributed to parties external to the NPO, which return or reduce a financial interest in the net assets of the NPO'.
- 2.25 An explanation of contributed capital will be included in Section 2, where it will be noted that:

'Contributed capital means future economic benefits or service potential that has been contributed to the NPO by parties external to the NPO, other than those

that result in liabilities of the entity, that establish a financial interest in the net assets of the entity, which:

- a. Conveys entitlement both to (i) distributions of future economic benefits or service potential by the NPO during its life, such distributions being at the discretion of the NPO, and to (ii) distributions of any excess of assets over liabilities in the event of the NPO being wound up; and/or
- b. Can be sold, exchanged, transferred, or redeemed.'

2.26 While net assets will no longer be an element, it is proposed that a definition of net assets as the residual of recognised assets minus liabilities will be retained. It is also proposed that Section 2 will also note that net assets may be managed by an NPO in separate funds which may be restricted or unrestricted. As the TAG has noted, NPOs also need additional guidance in the INPAG on restricted and unrestricted funds and reserves.

2.27 The IPSASB Revenue Standards Exposure Drafts introduce the concept of a compliance obligation, which is an entity's promise, or series of promises, in a binding arrangement to use resources in a specified manner. This captures all obligations arising from revenue transactions with binding arrangements. Obligations are binding when an entity has little or no realistic alternative to avoid them. Binding obligations can be legal obligation or non-legally binding obligations, and may give rise to a liability.

2.28 It is proposed that Section 2 will indicate that restrictions are externally imposed funding or other legal arrangements that require financial resources provided to the NPO to be expended, invested or retained by the NPO for a specific purpose or activity. It will note that a breach of these funding or other legal arrangements will usually require the NPO to return the financial resources to those that originally provided them and that the NPO may face censure from regulators for the misuse of these resources.

2.29 For unrestricted funds, the Section will note that these are freely available to be utilised by the NPO for any of its purposes or activities. It will explain that an NPO is free to internally designate funds for a specific purpose or activity, but that the absence of any externally imposed funding or other legal arrangement means that they do not have to be used for this purpose or activity.

Question 6: Does the TAG agree with the proposals to remove net assets as an element and the introduction of capital contributions and capital distributions?

Question 7: Does the TAG agree with the proposals to retain a definition of net assets and text related to the management of net assets in restricted and unrestricted funds?

Question 8: Does the TAG agree with the proposal for describing restrictions?

Value in use

- 2.30 The TAG raised a concern that value in use is presented in Section 2 as a term and concept that is unique to NPOs, but that value in use is also used in IFRS Accounting Standards. The TAG noted that this raises a broader point of principle about use of terms. The INPAG needs to be clear about which terms are NPO specific and which are used more broadly in IFRS and or IPSAS. Terms used more broadly in IFRS and/or IPSAS should have the same meaning in the INPAG.
- 2.31 The TAG also questioned whether the inclusion of value in use added a layer of unnecessary complexity, and that it could potentially be removed from the core guidance and if needed included in supporting text.
- 2.32 The principle that where a term is already used by international financial reporting frameworks it should have the same meaning within the INPAG is accepted, and the text will be reviewed to ensure that this is the case. With respect to the view that including value in use adds an unnecessary layer of complexity, it is proposed that value in use will be retained should it be included in the revised IFRS for SMEs Standard as long as conceptually this is appropriate in the NPO context. If necessary, the text may be revised, subject to the principle that the meaning of the term will be the same in the INPAG as it is in the IFRS for SMEs Standard.

Question 9: Does the TAG agree with the proposal to retain value in use if it is included in the revised IFRS for SMEs Standard provided this is conceptually appropriate in the NPO context and that any revisions to the text will ensure that the meaning of the term is the same in INPAG as it is in the IFRS for SMEs Standard?

Undue cost and effort provisions

- 2.33 The TAG noted that either:
- (a) the undue cost and effort provisions should be retained with an acknowledgement that there are some concerns about the level of judgement needed to apply it correctly and the possibility that some NPOs could hide behind these provisions to obscure transparency; or
 - (b) rather than including the undue cost and effort provisions in the concepts and pervasive principles, the INPAG could provide simpler options or make clear when a simpler option could be used within the relevant individual Sections.
- 2.34 The concerns about how the undue cost and effort provision may be used in practice, both from the perspective of the level of judgement needed and potential misuse are recognised. These are not, however, NPO specific issues. Under the 'rules of the road' there does not appear to be a sector specific reason

for departing from the IFRS for SMEs Standard should the undue cost and effort provisions be retained in the revised Standard. If retained in the IFRS for SMEs Standard, the proposal is to include in the undue cost and effort provisions in the INPAG with text included in the Implementation Guidance on how to use the provisions.

Question 10: Does the TAG agree with the proposal to retain the undue cost and effort provisions if these remain in the revised IFRS for SMEs Standard with text included in the Implementation Guidance on how to use the provisions?

3. Proposal for updating Section 2 Concepts and Pervasive Principles and providing Exposure Draft text to the TAG

- 3.1 As noted, updating the text of INPAG Section 2 Concepts and Pervasive Principles is dependent upon the timing of the revision to the IFRS for SMEs Standard by the IASB.
- 3.2 As soon as access is available to the IFRS for SMEs Exposure Draft, and subject to the TAG's views on the proposed approaches above, the INPAG Exposure Draft text for Section 2 Concepts and Pervasive Principles will be revised. It will be included in a full draft of the ED to be circulated before the next TAG meeting.

June 2022

Annex A - Log of advice and requests

Date	Requests	Status	Notes
04/05/2022	Consider in the development of financial statements whether not having an OCI Statement would work for all NPOs and bring further proposals back to the TAG.	In progress	Being examined as part of financial statements
04/05/2022	Terms in the Guidance should have the same definition as in other international standards where they have the same meaning	In progress	Terms in Guidance to be checked to ensure this is the case. The specific example raised 'value in use' may be changed depending on IFRS for SMEs revision.
04/05/2022	Leave the inclusion of value in use as a placeholder in ED1 until further topics have been developed	In progress	Value in use will be retained as placeholder although text may be changed depending on IFRS for SMEs revision.
04/05/2022	Maintain the undue cost and effort provisions in the draft Guidance if this continued in the update to IFRS for SMEs, but ask a specific matter for comment on this topic	In progress	Agreed.
06/04/2022	Consider whether the presentation of GPFRs should be in a separate section	In progress	High-level principles deemed useful. Will check against changes made in revised IFRS for SMEs
06/04/2022	Explain the source of the framework material for the concepts and pervasive principles and whether its use is conceptual or pragmatic for the purposes of INPAG.	In progress	To be included as part of updated Basis for Conclusions once we have the revised IFRS for SMEs Section 2
06/04/2022	Reproduce the comparison table between the IASB conceptual framework and the IPSASB conceptual framework	In progress	Will update table once have revised IFRS for SMEs Section 2 text. Consideration needs to be given as to whether this should be provided as part of Exposure Draft materials
06/04/2022	Be explicit about why IFRS for SMEs content is in the core guidance or application guidance so that it is principles based.	In progress	Will be included as part of Basis for Conclusions
06/04/2022	Socialise further with the PAG and DRG the section of INPAG that describes that if a user has the power to request other information that means that they are not a primary of GPFRs.	In progress	To do as part of providing ED text for comment
06/04/2022	Review the discussion in the IPSASB conceptual framework regarding the use of net assets and the relationship with equity.	In progress	This to be considered as part of amendments to net assets element
06/04/2022	Examine further 'restricted and unrestricted' funds in considering 'net assets' and explore 'funds and reserves' as a potential element. Look at terms and definitions currently being used in jurisdictions with NPO standards/guidance and raise as a specific matter for comment in the Exposure Draft.	In progress	This to be considered as part of amendments to net assets element
06/04/2022	Review IPSASB Revenue discussions to see whether conclusions on enforceability, and when potential obligations under an agreement can become actual liabilities if there can be more than one past event may have relevance.	In progress	This to be considered as part of work on elements once have revised IFRS for SMEs Section 2
05/10/2021	Drive the stakeholder groups from the definition of public benefit and the use of general purpose financial reports. Bring the ideas about stakeholder groups that would normally be captured in a conceptual framework into the proposed guidance.	Complete	Reflected in drafts to be approved

Date	Advice	Notes (if any)
04/05/2022	The financial statements may not need to be referred to in section 2 as they are covered in subsequent sections.	Will depend on whether revised IFRS for SMEs Section 2 maintains a financial statement approach to elements
04/05/2022	A definition of expenses that includes losses may not be intuitive. This could be addressed by defining loss as a separate element.	Reflects current IFRS for SMEs wording, will re-examine once we have revised IFRS for SMES Section 2
04/05/2022	The inclusion of value in use may add additional complexity that is not needed for stage 1 of the guidance	Propose retention as placeholder but will check revised IFRS for SMEs wording.
04/05/2022	Value in use is explained as a term unique to NPOs but it is used in IFRS. Need to be clear about which terms are NPO specific and which are used more broadly.	Terms in Guidance to be checked to ensure have same meaning when already used in international standards. The specific example raised 'value in use' may be changed depending on IFRS for SMEs revision.
04/05/2022	Retain the undue cost and effort provisions acknowledging that there are some concerns about the level of judgement needed and the possibility of some hiding behind these provisions to obscure transparency	To be retained if included in revised IFRS for SMEs. Will include text in implementation guidance about use of judgement and transparency
04/05/2022	Rather than the undue cost and effort provisions the Guidance could provide simpler options or make clear when a simpler option could be used	Undue cost and effort to be retained if in revised IFRS for SMEs
06/04/2022	The financial statements are included in section 2. This may not be needed at the conceptual level and can be dealt with in subsequent sections.	Will depend on whether revised IFRS for SMEs Section 2 maintains a financial statement approach to elements
06/04/2022	Recognising the importance of the presentation on GPFRs, it's not clear that this is a concept and pervasive principle. This could be separated into another section.	High-level principles deemed useful. Will check against changes made in revised IFRS for SMEs
06/04/2022	In drawing on both the IASB and IPSASB conceptual frameworks in developing the NPO concepts and pervasive principles make clear which is being used where. Colour coding may be useful for the Exposure Draft.	To be examined again once we have the revised IFRS for SMEs Section 2
06/04/2022	The core guidance together with the application guidance should be seen as one set of guidance with the core guidance succinct and the application guidance elaborating on the principles.	Looking at balance between core and application guidance to ensure consistent approach. Agree that core should be succinct
06/04/2022	The balance of emphasis on the information needs of primary users of GPFRs is on accountability rather than decision making, and this should be more balanced. It may be helpful to use the term resource allocation instead of economic decision making	Will look to add more on decision-making usefulness
06/04/2022	The users of the GPFRs should be brought forward from the basis of conclusions into the core guidance	In interests of succinct core guidance think current balance correct
06/04/2022	If financial statements are published and freely available then that meets the accountability aims of INPAG	Agreed that this is beneficial to accountability
06/04/2022	Equity can be viewed as synonymous with net assets and the difference is not clear and whether equity is a separate element. A clearer definition of equity is needed and examples would be helpful to understand how it is different to net assets.	This to be considered as part of amendments to net assets element
06/04/2022	There need to be clear criteria to separate transactions that impact income from those that impact net assets of an NPO where these are tied to financial statements.	Agreed, will ensure clear as part of element definition
06/04/2022	The term net assets may be viewed as a mathematical formula rather than as a defined term.	This to be considered as part of amendments to net assets element
06/04/2022	Unrestricted reserves are really important as there is a low level of understanding of their role in financial resilience	Agreed
06/04/2022	Take care that restrictions are not defined too broadly and that it is clear what is enforceable and what is designated. Note also that the term 'unrestricted' might not be commonly understood.	This to be considered as part of amendments to net assets element
05/10/2021	Consider whether governing boards should be considered a stakeholder group especially where they are the only/primary users of accounts in addition to	Will examine as part of any updates to users text

	accountability responses and consider how governing boards differ to other sectors.	
05/10/2021	Examine the approach taken by the IASB and IPSASB to primary users.	Have done so, text should reflect similar approach
05/10/2021	Consider whether regulators are primary users, given their access to information through their oversight role taking account of a recent study that identified regulators as a primary user.	Will examine as part of any updates to users text
05/10/2021	Consider whether employees are stakeholders and if so what capacity given mixed views about whether they are an internal stakeholder group.	Will examine as part of any updates to users text