



Technical Advisory Group Issue Paper

AGENDA ITEM: TAGED07-04

28 June 2022 – Online

Sections 3-7 – Financial statement presentation

Summary	This paper seeks comments on the proposed text for sections 3-7 of INPAG.
Purpose/Objective of the paper	Seek input from the TAG members on the proposed text for Section 3 <i>Financial statement presentation</i> ; Section 4 <i>Statement of financial position</i> ; Section 5 <i>Statement of income and expenses</i> ; Section 6 <i>Statement of changes in net assets</i> ; and Section 7 <i>Statement of cash flows</i>
Other supporting items	None
Prepared by	Paul Mason and Karen Sanderson
Actions for this meeting	<u>Comment</u> on the draft sections <u>Advise</u> on whether any additional guidance is required

Technical Advisory Group

Sections 3-7 – Financial statement presentation

1. Background

- 1.1 The financial statements have been included as a priority topic for phase 1 of the Guidance. The format of the financial statements formed part of the Consultation Paper. Feedback on the responses received was provided to the TAG at its May 2022 meeting.
- 1.2 This paper covers the format of the financial statements. The proposals in this paper reflect the feedback to the Consultation Paper, and the TAG's discussions on that feedback at the May 2022 meeting.
- 1.3 Proposals for the notes to the financial statements and accounting policies, estimates and errors are covered in Agenda Item TAGED07-03.
- 1.4 As noted previously, the INPAG incorporates Sections from the *IFRS for SMEs* Standard directly where there is no NPO sector specific reason for any change to be made. Where NPO-specific financial reporting issues have not been comprehensively or appropriately dealt with in the existing *IFRS for SMEs* Standard, or where there is no related Section, the INPAG may make a change to the *IFRS for SMEs* Standard.
- 1.5 To assist TAG members in understanding where text from the *IFRS for SMEs* Standard has been incorporated directly or been subject to change, the following approach is being used:

Text colour	Explanation
Black	Original IFRS for SMEs Standard text
Red strikethrough	Deletion of text within original IFRS for SMEs Standard text
Green	Change of terminology only
Purple	Text originated from IFRS Standards
Blue	Original INPAG text
<u>Blue underlined</u>	Text originated from IPSAS Standards

- 1.6 In addition to the proposed Exposure Draft text relating to each Section any related application and implementation guidance and its associated Basis for Conclusions, a further document maps the Section from the *IFRS for SMEs* Standard to the proposed Section of the INPAG.
- 1.7 A list of previous advice and requests relating to the topic are included as Annex A.

2. Issues affecting more than one financial statement

- 2.1 In developing financial statements that will meet the needs of NPOs and their stakeholders, some amendments to the requirements in the *IFRS for SMEs* Standard are proposed. These amendments reflect a number of issues, some of which will affect more than one financial statement. These issues are discussed below.

Restricted and unrestricted income and funds

- 2.2 The Consultation Paper discussed the separation of restricted from unrestricted funds, and this approach was generally supported by stakeholders. In the paper to the last TAG meeting, it was proposed that the separate presentation of income and expenses, net assets (and changes in net assets) for the aggregates of restricted and unrestricted funds would be required as a minimum. The same proposal was put to the PAG. Both bodies agreed with this approach.
- 2.3 To move this forward we need to agree what we mean by restricted and as a consequence what is meant by unrestricted. IPSAS 23 – *Revenue from Non-Exchange Transactions* uses the definitions in Table 1 below.

Table 1 – IPSAS 23 Definitions related to restrictions

Term	Definition
Conditions on transferred assets	stipulations that specify that the future economic benefits or service potential embodied in the asset is required to be consumed by the recipient as specified or future economic benefits or service potential must be returned to the transferor.

Restrictions on transferred assets	stipulations that limit or direct the purposes for which a transferred asset may be used, but do not specify that future economic benefits or service potential is required to be returned to the transferor if not deployed as specified
Stipulations on transferred assets	terms in laws or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity.

- 2.4 IPSASB is currently in the process of updating its standards relating to non-exchange revenue and transfer expenses. This work has created debate about the nature of the arrangement that needs to exist to consider an asset to effectively be restricted. IPSASB are moving away from consideration of performance obligations to compliance arrangements where the discussion has been around what constitutes an arrangement (legal or otherwise) and consideration of whether the arrangement includes specific rights and obligations which are enforceable through legal (or equivalent) means.
- 2.5 An alternate view on restrictions is provided by the UK *Statement of Recommended Practice* for charities, which adopts fund accounting. The definitions below are linked to UK trust law.
'Restricted funds may be either endowment or restricted income funds, depending on the nature of the restriction. The resources (the assets and liabilities) of each restricted fund are held and maintained separately from other funds. This is in recognition of the circumstances in which the resources were originally received, and/or the restrictions on that fund that determine the way those resources are subsequently to be treated.'
'Unrestricted fund is a legal term for the unexpended resources held by a charity on trust, comprising money and other assets that can be used for any of the charitable aims of the charity. The use of unrestricted funds is not restricted to any particular charitable purpose of the charity.'
- 2.6 In Section 2 of INPAG which covers the concepts and pervasive principles, we are currently describing restricted and unrestricted funds as follows.
Restricted funds are established by the NPO because of an externally imposed funding or other legal arrangement that requires them to be expended, invested or retained by the NPO for a specific purpose. A breach of these externally imposed funding or other legal arrangements will usually require the NPO to return financial resources to those who provided them. The NPO may also face censure from

regulators for the misuse of restricted funds, including the loss of regulatory and other financial privileges.

Unrestricted funds by contrast are described as those that are freely available to be utilised for any of the NPOs purposes. The NPO may internally designate these funds for a specific purpose, but there is no externally imposed funding or other legal arrangement that requires them to be used for this purpose.

- 2.7 In this paper, the questions addressed concern what line items/format might be presented in the financial statements. Detailed proposals regarding the accounting for restricted and unrestricted income and funds will be developed as part of the topics on non-exchange revenue and grant expenses that will be included in Exposure Draft 2. Definitions have been provided to help inform the discussion around presentation.

Question 1: From an NPO perspective what are TAG members views on what is meant by restricted? What transactions would you expect to see within restricted income, expenses, and net assets?

Question 2: Should the mandatory presentation in the primary statements include 'restricted' income, expenses and reserves or just reserves?

Equity

- 2.8 Equity is a term that is used in for-profit standards and is also included in the standards to be used by public sector entities. Equity is defined in the for-profit standards as the residual interest in the assets of the entity after deducting liabilities. This will include items that don't meet the definition of a liability such as share capital and will also include retained earnings and reserves, for example the revaluation reserve (sometimes called revaluation surplus).
- 2.9 The standards for the public sector recognise that some entities may have share capital and uses the term net assets/equity as an equivalent term to the 'equity' section of the balance sheet of for-profit financial statements. IPSAS 1 – *Presentation of Financial Statements* uses the term and defines net assets/equity as contributed capital, accumulated surplus or deficit, reserves and non-controlling interests.

- 2.10 Non-profit organisations will have a variety of different legal structures. Some may be incorporated entities, trusts, or various forms of unincorporated entity. It is possible that some entities that meet the definition of an NPO using the characteristics previously discussed have some form of equity claims on the organisation, either from historic set-up or because of jurisdiction specific legislation/regulation. However, it is not clear how common this will be.
- 2.11 The project secretariat is currently proposing to call the equivalent section in NPO financial statements '**net assets**', with this comprising contributed capital and accumulated surplus or deficit, split between restricted and unrestricted, reserves and non-controlling interests (for example a minority interest in an entity set up to support a number of non-profit organisations). Contributed capital would include all forms of equity claims including any shares that have been issued.
- 2.12 This paper only considers how such items should be presented in the financial statements; the terminology to be used and the items that will form contributed capital are being addressed in developing Section 2.

Question 3: What are TAG member's views about the term 'equity' and the frequency of shares or contributed capital being part of an NPOs financial statements? What forms might contributed capital take? Are there other factors to consider?

3. Section 3 *Financial statement presentation*

- 3.1 Section 3 explains fair presentation of financial statements, what compliance with the INPAG requires and what a complete set of financial statements is. Most updates to Section 3 relate to terminology and the use of language specific to NPOs.
- 3.2 The main area where INPAG departs from the requirements of the *IFRS for SMEs* Standard is in specifying the complete set of financial statements.
- 3.3 At the last TAG meeting, the Secretariat proposed a Statement of income and expenses that would total to surplus or deficit. Other changes in net assets would be presented in a separate Statement of changes in net assets. This

proposal has been taken forward in developing this section, and Sections 5 (Statement of income and expenses) and 6 (Statement of changes in net assets).

- 3.4 This approach is intended to emphasise the key numbers that are expected to be most relevant to users of an NPO's financial statements. In discussion with donors the emerging view is that the numbers which are of greatest significance are total income and expenses and the extent of unrestricted reserves, which many see as an indicator of resilience.
- 3.5 Information outside surplus or deficit will be important for some users of an NPO's financial statements. Consequently, the design of the Statement of changes in net assets is intended to ensure that information that would be presented in other comprehensive income under the *IFRS for SMEs* Standard is readily identifiable. This is discussed in more detail under Section 6 below.
- 3.6 Application Guidance to supplement the requirements of Section 3 has been developed, covering:
- Objectives of financial statements;
 - Financial statements naming and presentation;
 - Compliance with INPAG;
 - Going concern;
 - Consistency; and
 - Materiality and aggregation.
- 3.7 The Application Guidance covering compliance with INPAG addresses the disclosures and statements to be made by NPOs that are transitioning to full compliance with INPAG.
- 3.8 The proposed Implementation Guidance comprises the illustrative financial statements (including alternative presentations of some statements) and a table of presentation and disclosure requirements (which can be used as a checklist). These are based on their equivalents in the *IFRS for SMEs* Standard, updated where required for the amendments made to the proposed financial statements sections.
- 3.9 In some cases, the illustrative financial statements are incomplete. This is because some items will only be capable of being finalised once other sections have been completed, for example the section on the analysis of expenses.

Similarly, the table of presentation and disclosure requirements can only be completed once the note disclosures for each section have been determined.

- 3.10 The need to complete the illustrative financial statements and table of presentation and disclosure requirements at a later date will be highlighted in ED1. ED3 will seek comments on an updated, complete set of illustrative financial statements and table of presentation and disclosure requirements.
- 3.11 The Basis for conclusions explains the rationale for the approach taken to developing the financial statements. There is some (limited) duplication of content with the basis for conclusions for each financial statement. This approach has been taken to allow each Section to stand alone.

Question 4: Does the TAG support the adoption of a Statement of income and expenses that totals to surplus or deficit, with additional information presented in the Statement of changes in Net Assets?

Question 5: Does the TAG support the approach to the Application Guidance and the Implementation Guidance (for example, including alternative presentations of some financial statements)?

Question 6: Does the TAG have any additional comments on the drafting of Section 3 of INPAG?

4. Section 4 *Statement of financial position*

- 4.1 Revisions to the Statement of financial position proposed in ED1 are limited. Any updates have been limited to terminology; use of language specific to NPOs; and amendments to reflect revisions to the elements defined in Section 2 and elsewhere in the financial statements (for example, to report restricted funds separately from unrestricted funds in the net assets section of the statement).
- 4.2 In introducing the separate reporting of restricted and unrestricted funds, reference to accumulated surpluses or deficits or retained earnings have been removed as restricted and unrestricted funds are in effect an allocation of the accumulated surplus and deficits.
- 4.3 Application Guidance has been developed that covers restricted and unrestricted funds; current and non-current distinction; sequencing of

information; and information to be presented in the statement of financial position or the notes to the financial statements.

- 4.4 The illustrative financial statements (included in the Implementation Guidance to Section 3) presents two formats for the statement of financial position – a vertical presentation and a horizontal presentation. These are for illustrative purposes only; the proposed Guidance, in line with the *IFRS for SMEs* Standard does not specify a preferred format or order of line items.

- Question 7:** Does the TAG have any comments on the drafting of Section 4 of INPAG?
- Question 8:** Does the TAG agree that accumulated surpluses and deficits is not an important number and is not needed to be specifically referenced in the drafting of Section 4?

5. Section 5 *Statement of income and expenses*

- 5.1 Section 5 sets out the requirements for the Statement of income and expenses. This section is based on Section 5, *Statement of Comprehensive Income and Income Statement* of the *IFRS for SMEs* Standard, adapted to reflect the use of a statement of income and expenses that totals to surplus or deficit, as described earlier.
- 5.2 As a consequence of adopting the Statement of income and expenses, the following revisions to the requirements of the *IFRS for SMEs* Standard have been made:
- The choice of presenting a single statement of comprehensive income or a separate income statement and statement of comprehensive income is removed;
 - Items that form other comprehensive income are relocated to the statement of changes in net assets (see Section 6);
 - Restricted income and expenses are presented in separate columns;
 - Income from grants for, and donations of, non-current assets is presented separately from other grant and donation income;
 - The analysis of expenses text (which covers classifications based on either the nature or function of expenses) will be replaced by guidance on the classification of expenses to be published in ED3;

- Surplus or deficit from operating expenses is presented separately from other items of surplus or deficit (share of surplus or deficit of associates; gains or losses on disposal of assets; unrealised gains and losses on foreign exchange differences; and unrecognised gains and losses from fair value adjustments); and
- Application Guidance has been developed.

5.3 The illustrative financial statements (included in the Implementation Guidance to Section 3) presents two formats for the statement of income and expenses – one presenting income followed by expenses; the other presenting expenses funded by income. These are for illustrative purposes only; the proposed Guidance, in line with the *IFRS for SMEs* Standard does not specify a preferred format or order of line items.

- Question 9:** Does the TAG support the separate presentation of income from grants for, and donations of, non-current assets on the face of the Statement of income and expenses?
- Question 10:** Does the TAG support the adoption of a surplus or deficit from operating activities sub-total, with other gains or losses presented below this line?
- Question 11:** Does the TAG have any additional comments on the drafting of Section 5 of INPAG?

6. Section 6 *Statement of changes in net assets*

- 6.1 Section 6 of INPAG sets out the requirements for the Statement of changes in net assets. This replaces the requirements in Section 6 *Statement of changes in equity and statement of income and retained earnings* of the *IFRS for SMEs* Standard.
- 6.2 Individual components of net assets are presented, including restricted funds and unrestricted funds.
- 6.3 The Statement of changes in net assets includes the following sub-totals:
- Restatements of opening balance (changes in accounting policy, correction of errors);

- Total income and expenses for the period (surplus or deficit, income and expenses recognised directly in net assets – equivalent to total comprehensive income);
- Transfers between funds (for example, between restricted and unrestricted funds);
- Changes to contributed capital (contributed capital received and distributed; and
- Any other changes to net assets.

6.4 The Secretariat does not consider that Application Guidance is required for Section 6. The illustrative financial statements (included in the Implementation Guidance to Section 3) presents a single format for the statement of changes in net assets.

Question 12: Does the TAG have any comments on the drafting of Section 6 of INPAG?

7. Section 7 *Statement of cash flows*

- 7.1 No major revisions to the Statement of cash flows are proposed in ED1. Any updates have been limited to terminology; use of language specific to NPOs; and amendments to reflect revisions elsewhere in the financial statements (for example, to report restricted grants separately from unrestricted grants, and to report grants for non-current assets within investing activities). As a consequence, the background to this section has been shaded to light grey to show that it has not been reviewed in its entirety.
- 7.2 The proposed Guidance retains the option to use either the direct method or the indirect method of preparing the Statement of cash flows. The direct method is likely to produce information that is more useful to users of the financial statements and have a closer link to any donor or project reports that are developed for later stages of the IFR4NPOs project. However, the indirect method is likely to be simpler to implement and consequently the Secretariat do not consider it would be appropriate to remove an option permitted in the *IFRS for SMEs* Standard.
- 7.3 The Secretariat does not consider that Application Guidance is required for Section 7. The illustrative financial statements (included in the Implementation



Guidance to Section 3) presents two formats for the statement of cash flows – the direct method and the indirect method.

Question 13: Does the TAG have any additional comments on the drafting of Section 7 of INPAG?

Annexes

Annex A	Previous advice and request
Annex B	Section 3 – Financial statement presentation
Annex C	Section 4 – Statement of financial position
Annex D	Section 5 – Statement of income and expenses
Annex E	Section 6 – Statement of changes in net assets
Annex F	Section 7 – Statement of cash flows

June 2022

Annex A

Log of advice and requests

Date	Requests	Status	Notes
04/05/2022	Include a placeholder in ED1 on comparatives and consider for specific topics in the later EDs.	In progress	Draft with comparatives, ask question as SMC
04/05/2022	Include a placeholder in ED1 on the use of disclosure notes and consider for specific topics in later EDs	In progress	Note in ED1 that detailed disclosure requirements will be in individual topics

Date	Advice	Notes (if any)
04/05/2022	The proposed name of the statement as Statement of income and expenses works, but may not intuitively reconcile with the proposal to have surplus/deficit as a key reporting line.	Noted, will consider as section is drafted
04/05/2022	Allowing preparers to name the statement as appropriate will provide the ability to communicate to stakeholders, as long as this is not misleading	Consistent with IFRS for SMEs paragraph 3.22, will incorporate
04/05/2022	Agree that income should not generally be able to be deferred. Clarity is needed about the line between income with restrictions and income with limitations in considering deferral. Noted that a specific matter for comment in ED1 will support the development of material for non-exchange revenue in ED2.	Noted
04/05/2022	Caution about making a decision not to include comparatives now. Comparatives are important for users. There will need to be further discussion on general levels of disclosures.	As above