

Technical Advisory Group Issue Paper

AGENDA ITEM: TAGED08-03

29 & 30 September 2022 – Hybrid

ED 1 - General-Purpose Financial Reporting

Summary	This paper identifies issues arising from TAG members' reviews of the draft of ED 1 and seeks guidance on how to progress them.
Purpose/Objective of the paper	To seek the TAG's views on the range of issues identified, to provide feedback on the approach to responding to these comments proposed by the Secretariat, and to respond to the questions that will enable the finalisation of the ED.
Other supporting items	None
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Actions for this meeting	<p><u>Advise</u> on the issues raised, including:</p> <ul style="list-style-type: none"> • Endowments; • Liabilities for deferred revenue; • Non-controlling interests; • Offsetting; • Operating cycle; • Terminology – restricted cash; • Statement of cash flows; • Disclosures; and • Qualitative characteristics of non-financial information;

Technical Advisory Group

ED 1 - General-Purpose Financial Reporting

1. Introduction

- 1.1 The first complete draft of Exposure Draft (ED) 1 was circulated to TAG members in July for comment. The INPAG secretariat has reviewed the comments received, and have updated the ED to take account of the comments.
- 1.2 The INPAG secretariat has also identified a number of issues that need further discussion at this meeting, either because new issues have been raised in the comments, or because there are differing views on an issue.
- 1.3 This paper covers the issues identified in respect of general-purpose financial reporting, including narrative reporting. TAG members are asked for their feedback on the issues, and the proposed way forward.

2. Way forward

Endowments

- 2.1 Accounting for legacy bequests and endowments was agreed to be considered in a later Phase of the project. Because endowments come with restrictions on their use, some TAG members have questioned whether there should be specific reference to them in the INPAG sections on the financial statements, but there were differing view on whether the guidance should refer to endowments.
 - One member wondered whether it would be worth covering endowments, at least in the cash flow section; and
 - Another member suggested that if endowments were being left to another phase of the project, it would better not to use endowments as examples in the text.
- 2.2 Endowments are less common in some jurisdictions and its inclusion in the core text may cause confusion for some NPOs. For this reason, the INPAG secretariat proposes to replace any examples that use endowments in the core text.

- 2.3 However, endowments may be significant for some NPOs, and guidance that endowments will form part of an NPO's funds with restrictions will be helpful. However, there will be difficulty in including such guidance without fully developing the accounting treatment for endowments.
- 2.4 If limited guidance on endowments is included in INPAG at this stage, there are various options for its location. Such guidance could be included in Application Guidance or in Implementation Guidance. TAG members are asked for their views.
- 2.5 Similarly, guidance could be included in any of the sections covering the financial statements. The INPAG Secretariat is currently minded to include guidance in the cash flow section, as only guidance on reporting the cash flows would be required. TAG members are again asked for their views.
- 2.6 If the TAG considers that references to endowments should be included in INPAG at this stage, the INPAG Secretariat will draft the guidance based on the TAG's location preferences. For example, if the guidance is to be included in the Implementation Guidance for the statement of cash flows, the guidance could address the question of how the receipt of endowment funds should be classified in that statement.

Question 1: Does the TAG consider that INPAG should include references to endowments? If so, what is the preferred location for these references?

Presentation of funds with restrictions and funds without restrictions

- 2.7 Queries were raised regarding the content and presentation of funds with restrictions and funds without restrictions. This included whether the net asset separation between funds with restrictions and funds without restrictions would extend to assets and liabilities in the statement of financial position, and if there would be additional funds such as endowments, internally-restricted amounts and capital assets outside of these two categories.
- 2.8 The intention is that the statement of financial position will show only the aggregate carrying value of funds with restrictions and funds without restrictions. There is no requirement to provide a breakdown of assets and liabilities between these funds.

- 2.9 With respect to the possibility of additional funds, items such as endowments, internally restricted amounts and capital assets would be included within either funds with restrictions and funds without restrictions depending on the extent to which externally-imposed restrictions are placed on them. An endowment for example is likely to be included within funds with restrictions, while internally restricted amounts will be within funds without restrictions.

Question 2: Do TAG members agree that the statement of financial position will only show the net balances of funds with restrictions and funds without restrictions?

Question 3: Do TAG members agree that all funds will be included within either funds with restrictions or funds without restrictions?

Liabilities for deferred revenue

- 2.10 Accounting for revenue will be included in ED2. This will include guidance on when a liability should be recognised, for example, because a donation has been received but the revenue recognition criteria have yet to be met.
- 2.11 One TAG member suggested that guidance could be included in ED 1 on when a donation should be taken to revenue and when it should be recognised elsewhere, because of existing common practice.
- 2.12 If TAG members think such guidance would be helpful until ED 2 is issued, the INPAG secretariat would recommend including additional application in Section 4 *Statement of financial position*, noting that, in most cases, deferred revenue would be presented as a separate liability line item in the statement of financial position. The suggested text is as follows:

Some NPOs may receive grants or donations before the revenue recognition criteria are met. In such cases, the NPO should recognise an asset for the grant or donation received (whether cash or another asset) and a liability in respect of the deferred (unearned) revenue. Revenue will be recognised, and the liability derecognised, as the revenue recognition criteria are met. Unless the liability is immaterial, the liability should be presented as a separate line item in the statement of financial position. [Details of the revenue recognition criteria and the detailed accounting requirements will be included in Exposure Draft 2.]

- 2.13 If this guidance is included in ED 1, it may be helpful to include an additional line item in the requirements for the statement of financial position which will provide the link to the guidance.

Question 4: Does the TAG consider that INPAG should include application guidance regarding the presentation of deferred revenue in ED 1? Does the TAG consider that an additional line item should be included in the statement of financial position?

Non-controlling interests

- 2.14 Section 2 *Concepts and pervasive principles* notes that the reporting NPO may encompass controlled entities that are not wholly owned or controlled by the reporting NPO. Section 9 *Consolidated and separate financial statements* sets out requirements for balances and flows to be attributed to controlling and non-controlling interests and specifies how this attribution should be carried out.
- 2.15 Given the focus of NPOs on furthering their objectives for public benefit, it is less likely that an NPO will have controlling interests in other entities that are less than full control. This is because it makes it more difficult to affect the returns (non-financial benefits), which might be expected to be necessary in order for an NPO to meet its objectives.
- 2.16 A TAG member noted that some charitable foundations carry out significant investments in other entities, and to the extent that these achieve control (but not 100% control) of the entity being invested in, non-controlling interests will arise.
- 2.17 Where there are entities set up for financial return, the expectation is that they will mostly be set up by the NPO and fully owned. Some NPOs may hold controlling interests which are not 100% controlled for purely financial return, but it is not anticipated that this will frequently occur. As a consequence it is expected that the majority of NPO groups do not have any non-controlling interests and the requirements are not frequently applied.
- 2.18 As non-controlling interests are not expected to be common, no further application guidance is currently proposed.

Question 5: Does the TAG consider that INPAG should include application guidance regarding the treatment of non-controlling interest for the relatively small number of public bodies which carry out significant activity?

Maintaining 'other comprehensive income' (OCI)

- 2.19 INPAG proposes a statement of income and expenses that totals to surplus or deficit. Other items that would be presented in comprehensive income under the *IFRS for SMEs* Accounting Standard are presented in an extended statement of changes in net assets.
- 2.20 One TAG member continues to favour retaining other comprehensive income (OCI) in the performance statement. Given the feedback from stakeholders on the important figures for users of NPOs' financial statements, the INPAG secretariat recommend retaining the statements proposed in the draft ED 1.
- 2.21 The TAG member also raised some concerns about the presentation of items in the statement of changes in net assets. Some of these items will be dependent on the requirements of other sections of INPAG that are scheduled for ED 2 or ED 3. The TAG member recommends that, should the existing presentation be retained, that the requirements are reviewed once the remaining sections of INPAG are complete. The INPAG secretariat agrees that a review of the requirements should be carried out at this point.
- 2.22 These points will be raised in the basis for conclusions. In addition, as SMC 6a seeks feedback on the presentation of OCI, no further changes to ED1 are proposed.

Offsetting

- 2.23 Section 2 *Concepts and pervasive principles*, includes guidance on offsetting (also known as netting-off). This guidance is based on the guidance in the *IFRS for SMEs* Accounting Standard.
- 2.24 The draft ED1 includes additional guidance on offsetting in Section 3 (financial statement presentation) and Section 5 (statement of income and expenses). This guidance is additional to the guidance provided in the *IFRS for SMEs* Accounting Standard.
- 2.25 Some TAG members questioned the need for the additional guidance. These members did not consider that the guidance added significantly to the guidance

in Section 2, and noted that no additional guidance had been deemed necessary in Section 4 (statement of financial position).

- 2.26 The INPAG secretariat acknowledge that there is a degree of duplication, but consider that this may be helpful to less experienced preparers. The INPAG secretariat also note that the guidance in Section 5 provides guidance on a specific example where offsetting is permitted in the statement of income and expenses, which is likely to be helpful to NPOs. Consequently, the INPAG secretariat recommends retaining the additional guidance.

Question 6: Does the TAG agree with the recommendation that the additional guidance on offsetting is retained?

Operating cycle

- 2.27 Section 4, *Statement of financial position*, includes guidance on determining whether assets and liabilities are current or non-current. This guidance makes reference to the NPO's 'normal operating cycle' and a TAG member asked whether this term was defined.
- 2.28 No definition was included in ED1, and the term is not defined in the *IFRS for SMEs Accounting Standard*. Neither the full *IFRS Accounting Standards* nor *IPSAS* define the term, but these two suites of standards do provide a description of what is meant by 'normal operating cycle.'
- 2.29 Based on these descriptions, the INPAG secretariat has included the following description within INPAG at paragraph G4.8A:
- The operating cycle of an NPO is the time taken to convert inputs or resources into outputs. For instance, an NPO may receive donations or grants and use these resources to deliver services to meet the NPO's objectives. When the NPO's normal operating cycle is not clearly identifiable, its duration is assumed to be twelve months.*
- 2.30 The TAG member also questioned whether, in the context of NPOs, reference to an 'operating cycle' was helpful. The TAG member suggested that, as an alternative, assets and liabilities could be classed as current or non-current based on when the NPO expected to realise them, intends to sell or consume them, or intends to settle them. Paragraphs G4.5 and G4.7 already provides that a period of within 12 months is usually current and greater than 12 months

is usually non-current. The proposal from the TAG member would make this a rule, with no reference to the operating cycle.

Question 7: Do TAG members agree that the reference to 'normal operating cycle' should be retained? If so, do TAG members agree with the description suggested?

Terminology: restricted cash

- 2.31 TAG members identified the use of the term 'restricted cash' as being potentially confusing.
- 2.32 In paragraph G4.11b, restricted cash is used to mean cash and cash and cash equivalents that have restrictions due to reasons such as foreign exchange controls or legal restrictions, not because of any restriction placed on how the cash can be used by the providers of the resources. Paragraph G7.22 requires an NPO to disclose the amount of significant cash and cash equivalent balances held by the NPO that are not available for use by the NPO, with legal restrictions being one possible cause of the cash not being available to the NPO.
- 2.33 By contrast, paragraphs G7.23 and G7.24 require the disclosure of cash and cash equivalents, split between restricted cash and unrestricted cash. In this case, restricted cash refers to cash attributed to funds with restrictions, while unrestricted cash refers to cash attributed to funds without restrictions.
- 2.34 The INPAG secretariat agree that this terminology is likely to cause confusion, and propose amending the wording in paragraphs G7.23 and G7.24 to refer to cash attributed to funds with restrictions and cash attributed to funds without restrictions.
- 2.35 The disclosure requirements in paragraphs G7.23 and G7.24 are additional to those included in the *IFRS for SMEs* Accounting Standard. They are included to provide information on the amount of cash grants and donations received in the period (as opposed to the revenue recognise in the period) and will provide a link to the donor/project statements that are intended to be developed at a later date.
- 2.36 Given the potential for confusion between restricted cash and cash attributed to funds with restrictions, the TAG is asked for its views on whether the disclosure of restricted cash in paragraphs G4.11b and G7.22 will be helpful to users of

NPO's financial statements. If not, they could be removed to minimise the potential for confusion.

Question 8: Do TAG members consider that the disclosures of restricted cash in paragraphs G4.11b and G7.22 are useful to readers of an NPO's financial statements?

Statement of income and expenses – name of statement.

- 2.37 A further set of comments were received from TAG members in relation to terminology and concepts connected to the financial statements.
- 2.38 Some TAG members noted that the statement of income and expenses might be better called the statement of financial activity. This change in terminology has been discussed in previous meetings, with income and expenses thought to better reflect the NPO context rather than the broader term of activity. There was also concern about using a name that is used with different requirements in other literature (the UK Charities SORP). As the name of the statement is raised in SMC 5a, the INPAG secretariat proposes to retain the name statement of income and expenses for ED1.

Statement of cash flows

- 2.39 TAG members raised a number of points regarding the statement of cash flows, which are considered in the following paragraphs.
- 2.40 Some TAG members questioned whether the guidance on the indirect method of preparing the statement of cash flows should include donations of financial assets in the list of non-cash items. The INPAG secretariat note that this might be problematic, as there would be a need to distinguish between financial assets that are cash equivalents (treated as cash) and those that are not (treated as non-cash). Instead, the INPAG secretariat propose including additional application guidance.
- 2.41 One TAG member proposed amending the order of the guidance, and presenting the direct method before the indirect method. The INPAG secretariat note that the guidance follows the format of the *IFRS for SMEs* Accounting Standard, and therefore do not propose any changes.
- 2.42 The same member also considered that INPAG should recommend the use of the direct method. The INPAG secretariat note that the *IFRS for SMEs* Accounting

Standard makes no such recommendation. As many NPOs are expected to use the indirect method because it is simpler to use, the INPAG secretariat do not propose to include a recommendation that the direct method be used.

- 2.43 INPAG permits a choice as to how interest paid and interest and capital distributions (including dividends) received are classified in the statement of cash flows. One TAG member considered that such a choice was unnecessary and undesirable.
- 2.44 The INPAG secretariat notes that this choice is also allowed in the *IFRS for SMEs* Accounting Standard and (except for financial institutions), in the full *IFRS* Accounting Standards and in IPSAS. The INPAG secretariat recommend retaining the choice, which arises because there is no consensus on how interest and capital distributions should be classified.

Question 9: Does the TAG agree with the INPAG secretariat's recommendations to:

- Include Application Guidance in respect of donated financial assets;
- Retain the indirect method appearing before the direct method;
- Not recommend the use of the direct method; and
- Retain the choice as to how interest paid and interest and capital distributions received are classified in the statement of cash flows?

Disclosures

- 2.45 Some members questioned whether there should be a requirement somewhere in INPAG to disclose material items separately.
- 2.46 While the principle is addressed in Section 3, the INPAG secretariat agree that guidance in specific sections would also be helpful, and has included additional Application Guidance in Section 4 (statement of financial position) and Section 5 (statement of income and expenses) regarding material items.

Qualitative characteristics of non-financial information

- 2.47 The qualitative characteristics of useful financial information included in INPAG Section 2 *Concepts and Pervasive Principles* are taken from the *IFRS for SMEs* Accounting Standard. The section on the cost constraint on useful financial reporting has been amended slightly to indicate that cost is a pervasive constraint on the information that can be provided by financial and non-financial reporting.

- 2.48 In Section 35 *Narrative Reporting* requires that when selecting and presenting performance information and financial statement commentary in a general purpose financial report, an NPO shall apply the qualitative characteristics and the pervasive constraints on information identified in Section 2 *Concepts and Pervasive Principles*.
- 2.49 This follows the precedent of the New Zealand PBE FRS 48 *Service Performance Reporting Standard*. This requires entities when selecting and presenting service performance information to apply the qualitative characteristics of information and the pervasive constraints on information identified in the PBE *Conceptual Framework*. These are relevance, faithful representation, understandability, timeliness, comparability and verifiability so match those of INPAG and the *IFRS for SMEs Accounting Standard*.
- 2.50 The scope of the narrative reporting requirements in INPAG is broader than PBE FRS 48, and this is why additional requirements are included to require fair and balanced reporting and why additional guidance on presentation, comparative information and consistency of reporting has also been included. These additional requirements are similar to those noted in the IASB's Exposure Draft: *Management Commentary* which sets out some characteristics that management commentary should have in order to be useful. Where necessary additional information has also been included to explain for example that relevant information is that which is capable of making a difference in the decisions made by users, i.e. it is material. Some TAG members asked whether the IASB's ED should be used as the basis for Section 35.
- 2.51 The Secretariat's position is that the requirement to apply the qualitative characteristics when selecting and presenting the performance information and financial statement commentary required by Section 35 *Narrative Reporting* is appropriate. Maintaining a consistent set of qualitative characteristics across financial and non-financial reporting will also assist those who adopt INPAG. TAG's views are sought on whether these qualitative characteristics, along with the additional requirements and guidance, are appropriate for the non-financial information that will be included the narrative report.

Question 10: Do TAG members agree with the approach to qualitative characteristics required by Section 35 *Narrative Reporting*?

- 2.52 Questions were raised by TAG members as to why the heading of the relevant section in Section 2 remained as 'qualitative characteristics of useful financial information' when they are being used for non-financial information.
- 2.53 The title 'qualitative characteristics of useful financial information' was retained because the primary focus of both the *IFRS for SMEs* Accounting Standard and INPAG in this area is financial information. As the qualitative characteristics are being used for non-financial information though, the heading and subsequent paragraphs from G2.14 onwards have been updated to include reference to non-financial information. TAG's views are sought on this inclusion.

Narrative reporting and non-disclosure of sensitive information

- 2.54 Section 35 Narrative Reporting permits the non-disclosure of information that would compromise the safety or wellbeing of individuals working/volunteering for the NPO or those to whom it provides services. No note is required in the narrative report that a sensitive information exception has been used where this would have the effect of highlighting a sensitive activity.
- 2.55 It is accepted that non-disclosure without informing users is not an ideal position, and there is the possibility that the permission to not disclose on an exceptional basis could be misused to hide poor performance or financial problems. Some TAG members therefore did query whether a general statement should be required that certain information has not been included, to alert users that the narrative report is incomplete.
- 2.56 The requirement to not disclose that sensitive information has been withheld has received support from PAG and TAG members and the narrative reporting focus group. When coupled with the requirement to ensure that reporting is fair and balanced, it is seen as an appropriate measure given that narrative reporting is proposed to be mandatory.
- 2.57 SMC 11b has been included to seek views on whether NPOs should be permitted to exclude sensitive information and not disclose that information has been withheld.

Miscellaneous Issues

- 2.58 Section 3 of INPAG includes requirements for the extremely rare circumstances when management concludes that compliance with INPAG would be so misleading that it would conflict with the objective of financial statements of

NPOs. One member disagreed with the emphasis given to this guidance as it is likely to be rarely used.

- 2.59 The INPAG secretariat note that INPAG states that this will be extremely rare. However, it may arise, and it is important that NPOs know how to deal with the situation. The guidance is also found in the *IFRS for SMEs* Accounting Standard, and that similar wording is found in the full *IFRS* Accounting Standards and in IPSAS. Consequently, the INPAG secretariat recommend retaining the guidance.
- 2.60 Some TAG members asked whether it would be appropriate to mandate a classified statement of financial position. The INPAG secretariat noted that the TAG had agreed to leave the format of the statements flexible - for example, permitting the use of either a horizontal or vertical statement of financial position. The INPAG secretariat also noted that the example balance sheet uses headers and sub-totals for the main categories. No changes are proposed.
- 2.61 One TAG member questioned why the word 'performance' had been replaced by 'financial activity' when describing the statement of income and expenses in paragraph G5.1. The INPAG secretariat noted that some respondents to the Consultation Paper had concerns about implying that an NPO's financial performance is based on its surplus or deficit. No changes are proposed.
- 2.62 A line item for "surplus or deficit from operating activities" is shown as a required line item in the statement of income and expenses. Some TAG members questioned whether this appropriately captures operational activities for all NPOs, given difficulties in defining this in their jurisdictions.
- 2.63 The INPAG secretariat acknowledges that, while the TAG has reviewed the format of the statement of income and expenses at a previous meeting, a further review would be beneficial. However, the INPAG secretariat considers that the best approach will be to include an SMC on this topic, and review which lines are treated as operational in the light of the responses.



Question 11: Does the TAG agree with the INPAG secretariat's recommendations to:

- Retain the guidance on situations when management concludes that compliance with INPAG would be so misleading that it would conflict with the objective of financial statements of NPOs;
- Retain flexibility in the format of the financial statements rather than to mandate a classified balance sheet;
- Retain the reference to financial activity rather than performance when describing the statement of income and expenses; and
- Review which line items are treated as operational in the statement of income and expenses following the receipt of response to ED 1.

Question 12: Does the TAG have any other comments based on the feedback to the Sections relating to the financial statements and narrative reporting?

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