

Technical Advisory Group Issue Paper

AGENDA ITEM: TAGED08-08

29 & 30 September 2022 – Hybrid

ED1 Summary

Summary	To obtain feedback on the draft Summary for inclusion in ED1
Purpose/Objective of the paper	This paper describes the approach to the development of the Summary. It also sets out the proposed content for the Summary and its role in the Exposure Draft.
Other supporting items	TAGED08-04 – <i>ED1 Structure</i>
Prepared by	Karen Sanderson
Actions for this meeting	<p><u>Advise</u> on:</p> <ul style="list-style-type: none"> • The approach taken • The proposed content of the summary

Technical Advisory Group

ED1 Summary

1. Introduction

- 1.1 In the first draft of ED1, it was proposed to include an Overview section at the beginning of the document. This Overview was intended to be translated into Spanish, French and Arabic to help make the documents more accessible. A placeholder was included in the draft pending its full scoping and feedback on the draft documentation.
- 1.2 In feedback on the draft document one TAG member raised a question about whether a summary of the ED would be produced to help stakeholders engage with the document. In the drafting, the Secretariat agree that a summary might be more beneficial, hence the renaming from Overview to Summary.
- 1.3 This paper describes the approach to the development of the Summary and its proposed content.

2. Approach

- 2.1 The summary has been structured to provide:
 - An introduction, which is capable of being used by those that are new to the work of the project and its objectives;
 - An explanation of how the Exposure Drafts are being delivered and what they will contain;
 - An explanation of the contents of ED1 and who should read it; and
 - The main adaptations that have been made in ED1.
- 2.2 The intention is that this summary is translated into French, Spanish and Arabic. There are no plans at present to translate the Exposure Draft content itself into these languages. The summary will therefore be the key document for non-English speaking stakeholders to understand the proposals in the ED. Panels will be created to oversee the translations into French, Spanish and Arabic, where TAG member input would be highly desirable and beneficial.

- 2.3 To translate the Exposure Draft will require the permission of the IFRS Foundation and would need to comply with its quality processes. I don't foresee that the IFRS Foundation would not give permission to this, but it is a lengthy process and would impact the capacity of the project team and come at a cost.

Question 1: Do TAG members agree with the approach to the summary?

Question 2: Does the introduction provide sufficient content to allow those unfamiliar with the project and understanding of the context?

Question 3: Particularly in the context of the paper on the Structure of ED 1 (TAGED08-04), does the summary provide sufficient explanation of the structure of the project and its component parts?

Question 4: Is the status of each Section in INPAG clear?

Question 5: Do TAG members have any advice on the need for or processes for translation?

- 2.4 The draft of the Summary is included as Annex A.

3. Detailed content

- 3.1 The main content of the summary relates to the adaptations. The adaptations that are included in the summary are:
- The broad characteristics approach to defining NPOs
 - Primary users and their needs of general purpose financial reports (GPFRs)
 - The reporting NPO and its boundary
 - Basis of information included in GPFRs
 - The elements that form the basis of NPO financial statements and key concepts, like service potential
 - Narrative reporting
 - Financial statement names and their scope
 - Fund accounting and the presentation of funds with and without restrictions
 - Compliance with INPAG

- 3.2 The summary also highlights some contentious areas like comparatives and the role of the cash flow statement. It also explains who is expected to use INPAG and the role of jurisdiction standard setters and regulators.
- 3.3 These topic areas have been selected to create a stand-alone document that highlights to stakeholders the main issues that have been considered in the development of INPAG and the proposed way forward. Links have been inserted to the relevant SMC to help stakeholders navigate the key points.
- 3.4 The content has been developed to allow an understanding of the issue and how it has been addressed without reading any of the other documents. This risks the summary being overly long, but it might be advantageous from the perspective of translation.

Question 6: Do TAG members agree that these are the topics that should be included in the summary? Are there any topics that TAG members think should be included or any that can be removed?

Question 7: What advice do TAG members have on the balance of the content on each topic to achieve the objective of being understandable without accessing other documents?

Question 8: Do TAG members have any other comments on the Summary?

September 2022

Annex A – Summary

Introduction

Objectives

In many countries, non-profit organisations (NPOs) have no guidance or frameworks to support the preparation of financial statements. These are crucial for transparency, accountability and decision making. Funding organisations have filled this void by developing their own reporting requirements for NPOs, and while all have their merits, the variety of different requirements can create a heavy burden on the very organisations they want to support.

Private and public sector entities and their stakeholders have benefited greatly from the development and use of international standards since the 1970s. In a 2014¹ international survey, which had more than 600 responses from 179 countries, the majority of respondents agreed or strongly agreed that an international accounting standard or guidance specifically for NPOs would be useful.

The credibility of NPOs to stakeholders and particularly those who contribute funds is dependent on creating and maintaining trust. To strengthen the governance and financial management of NPOs, INPAG is being developed to meet the following three objectives:

- To improve the quality, transparency and credibility of NPO financial reports.
- To support the provision of NPO financial information that is useful for decision making and accountability, balancing the needs of preparers and users.
- To address specific NPO issues, which will promote the comparability of NPO financial reports.

A Consultation Paper² was issued in January 2021, setting out proposals to develop financial reporting guidance for NPOs (now called INPAG) and seeking feedback on a number of proposals including priority topics. There was overwhelming support for the development of INPAG and the proposals set out in the document.

Core premises of INPAG

INPAG is built on the core premises that it is accrual-based and includes non-financial information. Accrual-based accounting is required to provide a comprehensive view of the NPO's financial position and activity. It can improve the quality and transparency of financial reports to enhance accountability and decision-making. Accrual information is accepted as the basis of high quality international financial reporting standards. Including non-financial information enables the production of general purpose financial reports that present management commentary and other

¹ *International financial reporting for the not-for-profit sector (2014)* – A study commissioned by Consultative Committee of Accountancy Bodies in the UK and Ireland.

² The Consultation Paper, which was issued in two parts can be found at www.ifr4npo.org

narrative reporting alongside the financial information contained in the general purpose financial statements.

General purpose financial reports go beyond the information provided in general purpose financial statements and provide users with information to allow a meaningful understanding of an NPO's nature, objectives, strategy, risks, and performance.

Approach to INPAG development

INPAG will be developed over a number of phases. The IFR4NPO project is currently in Phase 1. Stakeholders were asked for their views on the priority topics to be included in Phase 1 of INPAG as part of the Consultation Paper issued in January 2021. Prioritisation is needed to publish INPAG in 2025 within the resources available.

Conceptual framework

INPAG has not been developed with its own conceptual framework. The experience of international standard setters is that it can take many years to develop an initial conceptual framework. Instead the concepts and pervasive principles that are used in the Exposure Draft of the Third Edition of the *IFRS for SMEs Accounting Standard* (the *IFRS for SMEs Accounting Standard*) have been reviewed to assess whether they are appropriate for NPOs. A number of adaptations have been made to the concepts and pervasive principles in the *IFRS for SMEs Accounting Standard*, with the most significant of these outlined below. These adaptations underpin INPAG, to create a framework that is appropriate for NPOs.

About this Exposure Draft

Structure of the Exposure Drafts

The First Edition of INPAG, which will be the end product of Phase 1 will be drafted over 2022 and 2023. This Exposure Draft is Part 1 of three Exposure Drafts that will be published to cover the full scope of INPAG in Phase 1. The draft Guidance will be provided through these Exposure Drafts. Publishing the draft guidance through three exposure drafts is intended to make it easier for stakeholders to comment on the proposals by breaking down INPAG into smaller packages. This will also allow feedback from Exposure Draft: Part 1 (ED1) to be incorporated into later drafts of the Guidance.

As a consequence, some of the proposals in ED1 may be refined in later Exposure Drafts. Any changes will be made clear in subsequent Exposure Drafts.

About this Exposure Draft

The focus of ED1 is to create the overarching framework for NPO financial reporting. It includes:

- Who will benefit from INPAG, both preparers and users
- Concepts and pervasive principles underpinning financial reporting
- The structure and scope of the financial statements
- Narrative reporting proposals

ED1 is built on equivalent sections from the IFRS for SMEs Accounting Standard. The contents are listed at the front of ED 1 and cover the Preface to Section 10 plus a new Section (Section 35) for narrative reporting. The remaining sections will be published in Exposure Draft – Part 2 (ED2) and Exposure Draft – Part 3 (ED3).

Against each Section a status shows the extent to which it has been reviewed to take account of NPO specific issues. The status will be described as one of the following:

Status	Description
Fully reviewed	The Section has been fully updated to reflect NPO requirements.
Aligned	The Section has been updated to align with Sections that have been fully reviewed, but has not in itself been fully reviewed
Unchanged	The Section has been updated for terminology changes, but is otherwise unamended
New	The Section does not exist in the <i>IFRS for SMEs</i> Accounting Standard and has been developed specifically for NPOs

Content of ED2 and ED3

ED2 will focus on revenue from grants and donations (non-exchange revenue) as well as the treatment of grant expenses. It will consider the situations where an NPO may be acting as a principal and when it might be acting as an agent. It will also consider presentational issues associated with foreign currency translation. In addition, ED2 will include a number of Sections that are updated for terminology changes but are not updated for any other reasons.

ED3 will focus on the classification of expenses, fundraising costs and inventory. ED3 will also include guidance on transition to the adoption of INPAG. As with ED2 it will include a number of Sections that are updated for terminology changes but are not updated for other reasons.

The chart below shows the NPO specific content in each Exposure Draft and its status, together with those Sections that are not expected to be changed other than for terminology changes.



INTERNATIONAL FINANCIAL REPORTING FOR NON PROFIT ORGANISATIONS

ED1 (Q4 2022)		ED2 (Q2 2023)		ED3 (Q4 2023)		Unchanged (ED 2 and ED3)	
Section	Title	Section	Title	Section	Title	Section	Title
Preface	Preface	23a	Non-exchange revenue	13	Inventories	11	Financial instruments
1	NPOs	23b	Exchange revenue	24b	Classification of expenses	12	Fair value
2	Concepts and pervasive principles	24a	Grant expenses	24c	Fundraising costs	14	Investment in associates
3	Financial statements			36	Transition to the Guidance	15	Joint arrangements
4	Statement of financial position					16	Investment property
5	Statement of income and expenses					17	Property, plant and equipment
6	Statement of changes in net assets					18	Intangible assets other than goodwill
7	Statement of cash flows					19	Business combinations and goodwill
8	Notes to the accounts					20	Leases
9	Consolidated and separate financial statements					21	Provisions and contingencies
10	Accounting policies, estimates and errors					22	Liabilities and equity
35	Narrative reporting					25	Borrowing costs
						26	Share based payments
						27	Impairment of assets
						28	Employee benefits
						29	Income tax
						30	Foreign currency translation
						31	Hyperinflation
						32	Events after the reporting period
						33	Related party disclosures
						34	Specialised advice

Who should review ED1

ED1 should be read by a range of NPO stakeholders. This includes:

- Regulators
- Standard setters
- NPOs
- Auditors
- Professional accounting bodies
- Public interest groups
- Finance ministries

- Tax authorities
- Academics

Adaptation area 1 - NPOs and their users

A broad characteristics approach to describing NPOs

A key decision in developing INPAG has been to determine what kinds of entities are included within the term 'NPOs'. This is important to enable the development of financial reporting guidance that meets the needs of users of NPO general purpose financial reports. INPAG is then developed with these types of entities in mind.

For the purposes of general purpose financial reporting, INPAG proposes in Section 1 *NPOs* a broad characteristics approach to defining NPOs, with NPOs being entities that display all of the following broad characteristics:

- (a) they have the primary objective of providing a benefit to the public;
- (b) they direct financial surpluses for the benefit of public; and
- (c) they are not government or public sector entities that should prepare general purpose financial reports under public sector financial reporting standards

As there will be circumstances where it is not always clear whether an entity displays all of the broad characteristics, indicators have also been developed (paragraphs AG 1.1 to AG 1.6 of the Application Guidance) to provide assistance in making judgements about whether an entity is an NPO.

A descriptive approach rather than a single definition was chosen because of the global diversity in both the types of entities that could be described as NPOs and the legal and regulatory frameworks that may apply to them. A single definition that could encompass all possible entities is not currently considered possible.

Other options were examined, including a narrow approach to determining scope based on defining NPOs with reference to jurisdictional-level legal or regulatory status, as well as the use of definitions from statistical reporting frameworks. However, these would potentially exclude many entities that could benefit from INPAG as they were not developed with the needs of users of NPO financial reports in mind.

Using broad characteristics requires the application of judgement. For example, the characteristic of 'providing a benefit to the public' may raise questions if it is only a small section of the public that is benefitting from the activities of the NPO. INPAG makes clear that the primary objective of the NPO does not have to be to provide benefit for all of the public.

INPAG requires that in applying the characteristics, careful consideration is given to

- (i) whether a sufficient section of the public benefits based on the NPOs purpose and

- (ii) that any private benefits that arise are as a result of the NPO carrying out its purpose are not the primary objective of the NPO.

SMC 1a seeks feedback on the extent to which respondents agree with the description of the broad characteristics. It also asks if the term ‘providing a benefit to the public’ would include all entities that might be NPOs, and if not, what should be changed.

Primary users and their needs of NPO general purpose financial reports

In Section 2 *Concepts and pervasive principles*, it is proposed that the primary users of NPO general purpose financial reports are:

- the public to whom the NPO provides services and goods;
- those resource providers who do not possess the authority to require an NPO to disclose the information they need for accountability and decision-making purposes;
- those that fulfil oversight functions on behalf of the public and resource providers.

Identifying the primary users is important so that the accountability and decision-making needs of these users are met. Central to the development of INPAG is that general purpose financial reports that include non-financial information are needed to meet the broader needs and expectations of users. The needs of the primary users will be reflected in the development of all INPAG Sections.

Primary users are stakeholders external to an NPO, and include service users, providers of financial support, regulators and broader society. A user who has the authority to require an NPO to disclose information is not considered a primary user as they can require an NPO to produce a special purpose financial report. Also, general purpose financial reports are not produced to meet the specific information needs of any individual user.

There may also be internal stakeholders who have an interest in an NPO’s general purpose financial reports. They include those charged with an NPO’s governance, staff whether paid or volunteers, and members. Internal stakeholders who have authority within the organisation are not considered primary users either, as they are permitted to request the information they need to discharge their functions.

The position of donors and their information needs is an important consideration for many NPOs. INPAG proposes that donors can in some circumstances be primary users. This is when they are acting like any other resource provider that does not have the authority to require the preparation of tailored financial reports. This may be, for example, when they are carrying out due diligence in advance of forming a financial relationship with an NPO. However, when exercising any authority to require an NPO to provide tailored information to their own individual needs as part of a funding or other arrangement, donors are not a primary user.

While donors and other stakeholders with such authority will continue to require the reporting of tailored information to them, INPAG can support a reduction in the reporting burden on NPOs through greater consistency in requirements across the sector. **SMC 2a** seeks feedback on the range of stakeholders, primary users and the description of their needs.

Which NPOs are expected to use INPAG?

One of the primary reasons that the *IFRS for SMEs* Accounting Standard has been chosen as the foundational framework of INPAG is to ensure that it can be adopted and applied by as wide a range of NPOs as possible. The objective in developing INPAG is to be inclusive with guidance that is useful for as many NPOs as possible. Adopting and applying INPAG can provide benefits for all NPOs, the users of their general purpose financial reports, and other stakeholders. This is regardless of the size of the NPO or the jurisdiction in which it operates.

INPAG is expected to be of most benefit to those NPOs whose users require accrual-based general purpose financial reports for accountability and decision-making purposes. INPAG will provide useful guidance for NPO specific transactions and economic events, but is not intended to be the primary framework for those NPOs that have public accountability as defined in full IFRS Accounting Standards. These NPOs will have more complex financial reporting needs that cannot be met entirely by INPAG. These NPOs will need to follow full IFRS Accounting Standards or the equivalent national GAAP if they are to meet the accountability and decision-making needs of their users.

For NPOs that have simpler stakeholder needs, accrual accounting may be more than is needed to meet the accountability and decision-making needs of their users. For these NPOs, a simpler cash-based framework may be sufficient. INPAG will still provide useful guidance, and can be used should these NPOs transition to accrual accounting over time.

INPAG will not therefore meet the needs of all NPOs as part of this current Phase of development. The possibility of tiered guidance to meet the needs of a wider range of NPO, including cash-based guidance for the smallest NPOs was considered. However, this is not deliverable within the timeframes to deliver the first set of guidance.

While it might not be the primary framework for some NPOs it will provide NPO specific guidance that will be useful to all. Which NPOs should use INPAG has been described in a way that is necessarily broad as conditions in each jurisdiction will vary. What is small in one jurisdiction might not be considered small in another and it would not be practical to set financial guidelines to indicate size. The intent is to be permissive and to drive the discussion about the application of INPAG at jurisdictional level based on their needs for users of financial reports. **SMC 1b** seeks feedback on whether it is clear which NPOs are intended to benefit from the use of INPAG and if not, what additional information would be useful.

The reporting NPO and its boundary

Also in Section 2, INPAG provides a definition of what is meant by a reporting NPO for financial reporting purposes. INPAG is aiming to provide a coherent and consistent principles based approach on which to make these decisions. This is to assist with the sometimes complex operational structures the NPOs experience. The definition in INPAG is based on economic substance that reflects the activities of an NPO, over its legal form. This is the same as the approach that is used in international financial reporting frameworks for the private and public sectors.

The proposals aim to ensure that an NPO prepares general purpose financial reports as a single economic entity or other complete set of activities related to its purposes. This is regardless of whether it is in practice made up of more than one entity, is a part of another entity (but needs to report in its own right), or is a single entity. INPAG also provides guidance about branches with indicators to assess whether an operational structure is a separate reporting entity.

INPAG reflects the possibility of an NPO being able to control another entity because of rights or relationships that it has with that other entity. The guidance describes this control as:

- having power over another entity (whether or not it is used),
- exposure or rights to variable returns (financial or non-financial) from its involvement with that entity, and
- the ability to use the power it has to affect the returns it gets from its involvement with the entity.

Section 9 *Consolidated and separate financial statements* seeks to ease application of the control principles by using a rebuttable presumption: presuming that control exists when an NPO (investor NPO) owns the majority of the voting rights of another entity (investee). It includes other situations where control would be presumed such as the power to govern the financial and operating policies of the entity and the power to appoint or remove the majority of the members of the board of directors or equivalent governing body where that board or body has control over the entity. This approach allows judgements to be formed based on individual circumstances. A more 'rules based' approach was considered, but not progressed because it would not be possible to anticipate all organisation structures that might arise. **SMC 9d** seeks feedback on whether a rebuttable presumption is useful, and if so, which common conditions are likely to be strong indicators of control. Application Guidance has been provided on how the control principles should be applied in the NPO context. **SMC 9c** seeks feedback on whether this is useful.

INPAG also allows that the boundary of a reporting NPO may be based on the existence of the information needs of a particular set of users, but only if this results in the production of general purpose financial reports.

Application guidance to assist in making judgements about a reporting entity can be found in paragraphs AG2.1 to AG2.14, supported by Implementation Examples that cover a range of possible situations including internal branches. They are intended to illustrate common factors that lead to

decisions about the existence and/or scope of a reporting entity. **SMC 2a** seeks feedback on the extent to which the NPO as a reporting entity is clear and on the process in the Application Guidance for identifying branches.

Consolidation requirements have not been reviewed as they were not prioritised for inclusion in Phase 1. The conceptual basis for consolidated financial statements for NPOs will be examined in a subsequent Phase. The terminology around consolidation and control has been made more appropriate for NPOs. **SMC 9b** seeks feedback on whether the terms 'controlled entity' and 'beneficial interest' capture NPO arrangements.

INPAG provides guidance on circumstances where entities might be excluded from consolidation if this provides better information. Deciding to exclude a controlled entity from consolidation is a significant judgement and not one that is expected to be used often. INPAG provides guidance on applying the qualitative characteristics in making such judgements. **SMC 9a** seeks feedback on whether the Application Guidance provided is useful.

Adaptation area 2 - Key concepts and principles underpinning INPAG

A set of concepts and principles are fundamental to the development and application INPAG. As it is not possible to develop a NPO specific conceptual framework from scratch now, INPAG is basing its concepts and principles on those that are used in the IFRS for SMEs Accounting Standard. It is also taking account of the conceptual frameworks used in the development of IFRS Accounting Standards and IPSASB standards. Adaptations are proposed where necessary so that these concepts and principles are relevant to NPOs.

Basis of information in GPFRs - characteristics

Section 2 describes the characteristics of financial information for NPOs. All international financial reporting frameworks state that if financial information is to be useful, it must be relevant and faithfully represent what it is purporting to represent. These have been included as fundamental qualitative characteristics of financial information in INPAG. Additional characteristics of comparability, verifiability, timeliness and understandability have been included as the enhancing qualitative characteristics of financial information. Collectively these form the qualitative characteristics that are proposed to be the basis of NPO financial reporting.

These characteristics provide a coherent framework for determining:

- the decision-usefulness of financial reporting information,
- guidance on what to do when qualitative characteristics may be in conflict, and
- overall cost-benefit constraints on financial reporting.

Drawing on the characteristics from the *IFRS for SMEs* Accounting Standard, (which is consistent with the conceptual basis of full IFRS Accounting Standards and IPSAS), provides an appropriate basis for NPO financial reporting. This is because they are likely to be the characteristics most useful to users

for making decisions and accountability purposes. **SMC 2b** seeks feedback on whether there is agreement with the qualitative characteristics of information.

The elements that form the basis of NPO financial statements

Financial statements are formed from classes of financial items that are referred to as elements. These elements create the basis of all financial statements and the relationships between them. Section 2 sets out the INPAG elements:

- assets,
- liabilities,
- income,
- expenses, and
- contributed capital

The definition of assets, liabilities, income and expenses is consistent with those used in international financial reporting frameworks. Contributed capital is a new NPO specific element. It is intended to capture the financial interest that third parties external to an NPO may have in the net assets of an NPO. Together with any funds that can only be distributed to those that have provided contributed capital, this is equivalent to equity or ownership rights that exist in private sector organisations, where a third party is entitled to some or all of the net assets of an entity.

The public that benefits from the activities of the NPO do not have entitlement to the historic surpluses or deficits and if they do through commitments made by the NPO, they would fall within the definition of a liability and not be associated with any rights over the NPO's assets.

The term equity has a strong private sector connection. It implies a formal ownership structure with holders of equity being entitled to financial returns based on that ownership. Equity is typically through share ownership. This may not reflect the reality of the majority of NPOs, where such considerations either will not exist or such ownership interests will be inconsequential. It is possible that donations are used to create an NPO, but these donations may not confer any rights to the donor. **SMC 2d** seeks feedback on the inclusion of contributed capital as an element and the types of contributed capital an NPO may have.

Fund accounting

Net assets are derived by deducting an NPO's liabilities from its assets. Also in Section 2, INPAG proposes that in addition to amounts related to contributed capital, net assets will include funds with restriction and funds without restrictions. Funds with restrictions and funds without restrictions are the accumulated funds of the NPO that have been generated from the NPO's surpluses and deficits.

NPOs will often be provided with financial resources where the provider of those resources restricts the use of those resources to specific purposes or activities. These funds with restrictions relate to

externally imposed funding or other legally based arrangements. INPAG makes a distinction between these funds with restrictions and other financial resources (funds without restrictions), including those that the NPO internally designates itself to specific purposes or activities. An understanding of the extent to which financial resources have restrictions on them is important for users of NPO financial reports as it can provide useful information about financial resilience. Funds without restrictions that can be deployed for any purpose, enable an NPO to respond to unforeseen events.

Identifying funds with restrictions is a basic form of fund accounting. It requires NPOs to separate the income and related expenses between funds with restrictions and funds without restrictions. Many NPOs may already record this type of information to meet the reporting requirements of those that provided the resources. INPAG does not require the separate reporting of all funds provided to support NPO programmes.

Not all jurisdictions will be familiar with fund accounting, and for those that are, the way in which restrictions are addressed may vary. Different NPO governance structures may also complicate what is considered to be an externally imposed arrangements. **SMC 2e** seeks feedback on the terms funds with restrictions and funds without restrictions and what this might mean for NPO financial statements.

Service potential

NPOs often hold assets in order to provide services rather than to generate and maximise cash flows. In this way, NPOs hold assets for their service potential rather than to generate financial returns. INPAG proposes to include this concept of service potential to recognise that NPOs operate for the benefit of the public rather than to make profit. The concept of service potential has been included within the paragraphs on measurement in Section 2 to emphasise the rationale for NPOs activities, which are to provide a benefit to the public.

Service potential has also been separated from the idea of 'economic benefit'. This makes a distinction between economic resources that are managed to provide an economic benefit, generally through cash generation, and service potential, which may not result in cash generation.

The concept of service potential is not explicitly recognised in the IASB Conceptual Framework as it is focussed on profit-oriented entities, but it is included in the IPSASB's Public Sector Conceptual Framework. It is also recognised in some jurisdictional-level frameworks.

Service potential may not be a concept that is familiar to many NPOs and the users of their general purpose financial reports. There will be practical considerations about how to measure service potential that will need to be developed in future editions of INPAG. **SMC 2h** seeks feedback on whether service potential should be introduced into the concepts and pervasive principles.

Adaptation area 3 - Narrative reporting

As previously noted, the nature of NPOs and their primary objective of providing a benefit to the public means that the broader needs and expectations of users can only be met through the inclusion of narrative reporting as part of general purpose financial reports. Proposals for narrative reporting are contained in Section 35.

NPOs are required to use the same qualitative characteristics in selecting and presenting narrative reporting information as for financial information. Narrative reports must also be fair and balanced. Narrative reports must cover the same reporting NPO and reporting period as the financial statements, so that there is consistency between the financial and non-financial information presented.

A principles-based approach has been developed that includes a set of mandatory core requirements to be applied by all NPOs. This mandatory requirement is deemed appropriate rather than a recommended practice statement because narrative reports have the potential to bring significant benefits to users and NPOs. NPOs are to present integrated information that provides:

- information to enable users to understand the performance objectives of the NPO;
- what it has done during the reporting period in working towards those performance objectives; and
- commentary to discuss and analyse the NPO's financial statements.

This minimum mandatory content is based on existing international financial reporting frameworks. This is designed to ensure a base level of consistency and comparability amongst all NPOs applying INPAG. **SMC 11a** seeks feedback on the principles proposed to underpin narrative reporting.

There have been calls to expand the mandatory core to other areas that are important to NPOs and their users such as climate reporting and broader sustainability reporting. The mandatory content has been kept to a minimum to lower the barriers for adoption. NPOs may extend their narrative reports beyond the core provided that the mandatory topics and elements that are important to users of all NPO general purpose financial reports have been met. NPOs may also apply frameworks such as integrated reporting in presenting narrative reports. INPAG therefore, provides considerable flexibility in how to meet the mandatory requirements.

Mandatory narrative reporting may pose challenges for those NPOs that engage in activities that might be sensitive for example, culturally, or for religious or political reasons. INPAG permits non-disclosure of aspects of performance information and financial statement commentary where an NPO engages in 'sensitive' activities. Narrative disclosures can therefore be omitted where they would compromise the activities of the NPO, for example specific human rights programs.

INPAG does not require NPOs to disclose where such information has been withheld. There is the possibility that the permission to not disclose withheld information could be misused by NPOs as a way of hiding poor performance or financial problems. **SMC 11b** seeks feedback on the scope of the

minimum mandatory narrative reporting requirement and in particular the importance of climate and broader sustainability reporting at this point. The question also seeks views on the exclusion of sensitive information.

For some NPOs transitioning to accrual accounting, the narrative reporting requirements may pose an additional challenge. **SMC 11c** seeks feedback as to whether an extended transition period would assist NPOs in overcoming any challenges that they may face in meeting these mandatory requirements.

Adaptation area 4 - Requirements of financial statements

Financial statement names and scope

In Section 5, INPAG proposes a statement of income and expenses that sums to a surplus or deficit. The title of the statement reflects feedback that 'statement of income and expenses' is more intuitive for the users of NPO financial statements. This was preferred over 'statement of financial activities' or statement of financial performance'.

The statement of income and expenses will include all transactions relating to an NPO's operating activities, including its realised gains and losses. This is to allow the focus of the statement to be on the excess or deficit of income over expense rather than on unrealised gains and losses that come from revaluations at the balance sheet date. For now the statement will include unrealised gains and losses that are required to be presented as part of the surplus or deficit by Sections of INPAG that have yet to be reviewed. Unrealised gains and losses not required to be shown as part of the surplus or deficit will be included in a statement of changes in net assets.

In Section 6, the statement of changes in net assets will show the movement on contributed capital, funds with and without restrictions and any non-controlling interests. Items that the *IFRS for SMEs Accounting Standard* requires to be presented in other comprehensive income will be presented together in this statement. This will ensure that the information that is included in other comprehensive income is clearly identifiable for those users who would find such information useful.

These proposals differ from the financial statements prescribed by the IFRS for SMEs Accounting Standard. They have been made following feedback from stakeholders that the most important figures about an NPO's financial activities in any reporting period are its income, expenses and surplus or deficit. Feedback has also conveyed the desire for simplicity in the presentation of information, with information about unrealised gains and losses seen as less important.

While INPAG refers to the statement of income and expenses it allows an alternative title to be used as long as using an alternative is not misleading to the users of the financial statements. However, a naming convention that is commonly understood across the sector would be preferable. **SMC 5a** seeks feedback on the title of the statement.

The INPAG proposals differ to the IFRS for SMEs Accounting Standard as well as to the financial statements under IPSAS standards, but are more closely aligned with IPSAS. **SMC 6a** seeks feedback on the scope of the statement of changes and net assets.

Presentation of funds with and without restrictions

As noted in adaptation area 2, one of the concepts proposed for INPAG is that fund accounting is adopted with a split between funds with and without restrictions. Stakeholders are overwhelmingly of the view that transparency over funds with restrictions is important. Section 4 *statement of financial position*, Section 5 *statement of income and expenses* and Section 6 *statement of changes in net assets* set out the INPAG requirements. In summary NPOs must present in aggregate each of the following:

- Income with restrictions and income without restrictions with the related expenses in a column format separately in the statement of income and expenses;
- Balances for funds with restrictions and funds without restrictions in the statement of financial position at each balance sheet date; and
- Movements in those funds in the statement of changes in net assets.

Separating aggregates of income with restrictions and income without restrictions on the face of the statement of income and expenses will allow users of the financial statements to understand how much of an NPO's income recognised in each year has limitations. It is also showing the extent to which in-year activities have been funded by discretionary funds.

Showing separately the balances on the funds with restrictions and funds without restrictions will show the level of funds that can be used to further the NPO's ongoing operations. Providing a reconciliation between the opening and closing balances on the funds through the statement of changes in net assets will allow users to see the extent to which restrictions are released. As noted previously this information is useful in assessing the financial resilience of an NPO.

INPAG limits the presentation to key aggregates, without requiring all balances to be separated. It does, however, require that material funds are disclosed for the statement of financial position and the statement of changes in net assets on either the face of the statement or in the notes to the accounts. Disaggregation of balances may be made in the notes to the financial statements if this is useful.

Presenting information about funds with and without restrictions on the face of the primary financial statements could increase their length and complexity. The inclusion of comparatives may add to concerns about length and complexity. The approach proposed is intended to strike a balance between users' information needs, the need to avoid making the financial statements overly complex, and the costs to the NPO of presenting information about each fund.

SMC 4b, SMC 5c and **SMC 6b** seek feedback on the requirement to separate the aggregate of transactions and balances with and without restrictions on the statement of financial position, statement of income and expense and statement of changes in net assets respectively.

The role of cash flow information

The cash flow statement potentially has greater significance for NPOs given the reporting requirements of funders are frequently for cash-based information. A new statement (optional) is being considered, with the potential for inclusion as part of ED3.

Ahead of these considerations INPAG in Section 7 *statement of cash flows* requires that the statement of cash flows and the related notes include additional information relating to donations and grants. As donations and grants are a key feature of an NPO's financial activities, it is important that users of the financial statements have the information needed to understand the donations and grants received by an NPO in the reporting period. While INPAG retains the choice of using either the direct or indirect method of preparing a cash flow statement, it requires that grants with restrictions to be shown separately from grants without restrictions, as well as cash donations. Where the indirect method is being used the separate disclosure of donations of assets is required. As this information is likely to be necessary to satisfy reporting to the providers of those funds, it is considered that the cost will not outweigh the benefit to users. **SMC 7a** seeks feedback on the requirement to present cash donations and grants separately in the Statement of cash flows.

Grants received to fund the purchase or creation of non-current assets (capital items) are required to be disclosed separately as part of 'investing activities'. These grants are frequently cited as a challenge for NPOs, where the providers of the grants require reporting that shows how the grant received has been spent. The disclosure of this information on the face of the cash flow and in the notes to the accounts (where relevant) may go some way to addressing the needs of these stakeholders. **SMC 7b** seeks feedback on treating donations and grants for the purchase or creation of capital items as investing activities.

Comparatives

Financial statements generally include comparative information for all items presented in the primary statements, and for most of the items disclosed in the notes to the financial statements. INPAG currently retains the requirements for comparative reporting that exist in the *IFRS for SMEs* accounting standard.

Comparative information can make the financial statements appear more complex, but does provide more information that is useful to the users of the financial statements. As the sections of INPAG dealing with NPO-specific transactions are developed for later Exposure Drafts, the need for comparative information for these transactions will be reviewed. **SMC 3b** seeks feedback on whether comparatives should be provided for all numbers on the face of the financial statements. This feedback will be considered in the further development of INPAG.

Compliance with INPAG

Users of the financial statements, however, need to understand the basis on which an NPO's financial statements have been prepared as this assists with comparability. INPAG requires an NPO whose financial statements comply with INPAG to make an explicit and unreserved statement of such compliance in the notes. Where an NPO is transitioning to INPAG, it will not be able to state compliance with INPAG. Instead, it should comply with the disclosure requirements in Section 36-*Transition to the Guidance*, which will be included in ED3.

Some NPOs may choose to apply aspects of INPAG but not the full requirements. This might be part of a plan to fully adopt INPAG, but outside to the permitted transition arrangements. Alternatively NPOs that are required to follow an accounting framework other than INPAG may use aspects of INPAG. It would be beneficial for these entities to explain why they are selectively using INPAG, but it must be clear that compliance with INPAG cannot be asserted. There may be other reasons why NPOs cannot assert compliance with INPAG. **SMC 3a** seeks feedback on the requirements for stating compliance with INPAG.