



# Technical Advisory Group Issue Paper

AGENDA ITEM: TAGED14-04  
28-29 Sept 2023 – Hybrid

## Equity

Summary	The paper provides TAG members with an overview of potential amendments to the concept of equity that are being considered by the Secretariat.
Purpose/Objective of the paper	The paper provides an overview of how the concept of equity was included in Exposure Draft 1, responses to those proposals and a survey that has subsequently been carried out to gain additional understanding of what kinds of equity instruments and claims NPOs might have. It provides TAG members with potential changes to the concept of equity that are being considered by the Secretariat by focusing on control and the implications this could have for Section 2 <i>Concepts and pervasive principles</i> and Section 22 <i>Liabilities and equity</i> .
Other supporting items	N/A
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Actions for this meeting	<b>Comment on</b> the: <ul style="list-style-type: none"><li>• Secretariat's view that the concept of equity needs to be revisited;</li><li>• proposals that control as well as financial interest be considered; and</li><li>• potential implications for Section 2 and Section 22.</li></ul>



# Technical Advisory Group

## Equity

### 1. Introduction

- 1.1 This paper provides:
- an overview of how the concept of equity was included in Exposure Draft 1;
  - responses to those proposals and a survey that has subsequently been carried out to gain additional understanding of what kinds of equity instruments and claims NPOs might have;
  - potential changes to the concept of equity that are being considered by the Secretariat by focusing on control;
  - implications for Section 2 *Concepts and pervasive principles* and Section 22 *Liabilities and equity*.

### 2. Equity in Exposure Draft 1

- 2.1 Exposure Draft 1 included Section 2 *Concepts and pervasive principles*. Amongst a number of important concepts included in this section were the financial statement elements. The *IFRS for SMEs* Accounting Standard follows the IASB Conceptual Framework in including equity as an element of financial statements. Equity is defined in these standards as the residual interest in the assets of the entity after deducting all its liabilities, and it effectively encompasses all net assets.
- 2.2 Previous discussions with the TAG included the potential inclusion of equity as an element in INPAG. As noted during those discussions, the term equity implies a formal ownership structure with holders of equity being entitled to financial returns and the residual of net assets based on that ownership. It was felt that this was unlikely to reflect the reality for the vast majority of NPOs, where such considerations either will not exist or such ownership interests are likely to be inconsequential.
- 2.3 While the term 'equity' and its association with ownership was unlikely to be relevant for most NPOs, it was agreed that there needed to be an element that reflects the possibility of a party external to the NPO having a financial interest in the net assets of the NPO.
- 2.4 It was agreed with the TAG that the retention of the element of equity was preferable to the definition of a new element that ultimately reflected the same underlying concept. As such, equity was included as a financial statement element, with the Application Guidance providing additional detail on its use in the NPO context.
- 2.5 The Application Guidance defined equity as future economic benefits or service potential that have been contributed to the NPO by parties external to the NPO,

other than those that result in liabilities of the NPO, that establish a financial interest in the net assets of the NPO, which:

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

With movements in equity comprising contributions from holders of equity claims and distributions to holders of equity claims.

- 2.6 Although the majority of the TAG agreed with this approach to the inclusion of equity as an element, one member disagreed with the definition of equity. They also noted concerns that there were transactions and economic events that might not be adequately captured by the elements.

### 3. Exposure Draft 1 responses and survey

- 3.1 Although a full analysis has not yet been undertaken of Exposure Draft 1 responses, there were a number of responses that disagreed with the proposals around equity. These responses ranged from those who argued that equity as defined could not exist for an NPO at all as this would mean the entity was for-profit, to others who noted that equity should be used in the same way in INPAG as it was in the *IFRS for SMEs Accounting Standards* (i.e. the residual interest in the assets of the entity after deducting all its liabilities) with there subsequently being no need to introduce a separate concept of net assets.
- 3.2 While not agreeing with all of these responses, the Secretariat does accept that there are issues with the Exposure Draft 1 proposals, which have become apparent as initial work has been undertaken on modifying Section 22 *Liabilities and equity*. At the heart of this is being clear on the characteristics of equity instruments for NPOs and the extent to which this provides ownership and/or entitlement to the net assets of an NPO. This includes what kinds of financial instrument might be classified as a liability or equity, and how equity as defined in Section 22 of the *IFRS for SMEs Accounting Standard* interacts with the proposed INPAG definition.
- 3.3 As a result, and in order to gain a better understanding of what kinds of equity instruments NPOs might have and what this entitles holders of equity claims related to these equity instruments, a survey has been conducted using the IFR4NPO newsletter. Responses to this survey, which is still open, show a mixed picture to date. While some respondents have indicated that there is the possibility of share capital or a similar form of equity, this did not appear to provide an entitlement to anything other than a return of funds. As such these were more similar conceptually to liabilities.

#### 4. Proposals around control

- 4.1 Given the issues highlighted through responses to Exposure Draft 1, initial examination of Section 22 *Liabilities and equity*, and the survey results to date, the Secretariat considers that the concept of equity in INPAG needs to be revisited.
- 4.2 In particular, the Secretariat considers that in examining the interplay between ownership and equity, focus must also be placed on the extent to which control is obtained over the NPO by external parties when they provide funding to the NPO, in addition to the establishment of a financial interest in the net assets of the NPO.
- 4.3 For many NPOs, it is expected that where external parties provide funding this will not provide entitlement to ongoing distributions and any excess of assets over liabilities in the event of the NPO being wound up. In such cases it would be expected that these be recognised as a liability.
- 4.4 In other cases, funding might provide some form of control through governance rights, but no entitlement to ongoing distributions and any excess of assets over liabilities in the event of the NPO being wound up. Exposure Draft 1 has already indicated that this would not be expected to be recognised as equity.
- 4.5 Some NPOs, may have funding from external parties that provides an entitlement to ongoing distributions and any excess of assets over liabilities in the event of the NPO being wound up. This type of funding may not in itself give the contributor of equity claims any control over the NPO. The ability to control would depend on the right provided by the financial instrument. Where the financial instrument does not provide control, the Secretariat considers that funding from these types of equity claims could be recognised as non-controlling interests.
- 4.6 As noted above it is possible that a financial instrument does give the holder, or holders or an equity claim control over an NPO. In these rare cases an NPO may have funding provided by external parties that provides an entitlement to ongoing distributions and any excess of assets over liabilities in the event of the NPO being wound up as well as control. It is this type of instrument that the Secretariat considers could be recognised as equity.
- 4.7 The concept of control in these circumstances would be the same as those in Section 9 *Consolidated and separate financial statements*. This section defines control as:

*being exposed, or having rights, to variable returns from its involvement with the NPO and having the ability to affect those returns through its power over the NPO.*(G9.8)

*Thus, controls exists if, and only if, all the following apply:*

- (a) power over the entity*
- (b) exposure, or rights, to variable returns from its involvement with the entity and*
- (c) the ability to use its power over the entity to affect the amount of its returns.*(G9.9)

power exists where there are existing rights that give the current ability to direct the **relevant activities**, that is the activities that significantly affect returns. Rights to:

- (a) direct the policies of the governing body of the NPO;
- (b) significantly amend or veto service or capital budgets relating to the relevant activities of the NPO; or
- (c) direct the transactions of the NPO that relate to its **relevant activities** that may individually, or in combination or together with other factors, give the ability to direct the relevant activities of the NPO. (G9.11)

4.8 As a consequence control may not be through the significance of the amount of funding provided, but through the exercise of rights such as the ability to withdraw the funding, appoint members of the governance body or independently determine the NPO's mission or objectives.

4.9 Control in this context would be akin to ownership in private sector organisations. Given the characteristics of NPOs, this is expected to be rare.

4.10 In summary, where an NPO has external funding contributions they would be characterised as follows:

Type of funding	Element
Funding that does not provide for distributions or an interest in net assets	Liability
Funding that provides control through governance rights, but no entitlement to ongoing distributions and any excess of assets over liabilities	Liability
Funding that provides for distributions, an interest in net assets but no control	Non-controlling interest
Funding that provides for distributions, an interest in net assets and control through additional rights	Controlling interest

**Question 1:** Do TAG members agree

- i. that the concept of equity needs to be revisited?
- ii. that a focus on control as well as the establishment of a financial interest should be considered?
- iii. That this is likely to be rare, or do TAG members have examples of where this might exist?

## 5. Implications for Section 2 and Section 22

- 5.1 Any change to the definition of equity would require consequential amendment to Section 2. In addition to the change in definition of equity in the NPO context, amendments may also be required in relation to related recognition and derecognition concepts and principles.
- 5.2 Section 22 will need to be amended to ensure that it aligns conceptually with the INPAG concepts and principles regarding liabilities, equity and net assets. Section 22 would be updated to reflect the characteristics of equity that will result from these considerations. This could include specific authoritative guidance related to liabilities and equity instruments that are common for NPOs, based on newly defined characteristics of equity.

**Question 2:** Do TAG members agree:

- i. with the implications highlighted for Section 2 and Section 22?
- ii. that there are no further implications to these and other sections that need to be considered?

## 6. Next steps

- 6.1 The Secretariat will further consider the definition of equity and will bring this issue back to the TAG for further discussion ahead of finalisation of Exposure Draft 3.

September 2023