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Dear Karen and team

Submission on INPAG Part 1 Exposure Draft

International Financial Reporting for Non-Profit Organisations (IFR4NPO)

Thank you for the opportunity to make a submission on the above Exposure Draft (ED). As a member of the IFR4NPO's Practitioner Advisory Group (PAG), and of the research team that undertook in the CCAB Commissioned research in 2013/14 (Crawford et al., 2014) referred to in the ED, I am very supportive of the IFR4NPO project.

The INPAG work will importantly introduce a set of internationally-acceptable and legitimate standards for a broad range of non-profit organisations (NPOs) including those that some define as social enterprises, and other social-purpose entities that do not fit a for-profit or public sector reporting model. While I initially noted that I would prefer that IPSAS were the starting point INPAG due to the better applicability of that Conceptual Framework, I recognise that the team have balanced time and resources to bring in NPO-specific guidance onto an existing framework.

Although as a member of the Practitioner Advisory Group (PAG) of IFR4NPO I have been invited to provide input at various stages of this project, my responses below are made in my personal capacity and cannot be seen to reflect the views of the New Zealand Accounting Standards Board of which I am Chair, nor of Victoria University of Wellington. I have drawn on my published research to underpin specific points and for empirical insights into my reasoning behind them.

My answers to the questions in the ED are provided below. I trust these are helpful in moving INPAG forward to completion.

Yours sincerely,

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Question 1: General Comments

- a) Is the structure of INPAG helpful? If not, how could it be improved?
- b) Do you have any other comments (including regulatory, assurance or cost/benefit) relating to this INPAG Exposure Draft? If so, explain the rationale for any points you wish to make.

- a) The structure of the ED and proposed structure of INPAG is what one would expect from an accounting standard, comprising guidance, definition of key terms, basis for conclusions and implementation guidance. In that sense there is a familiarity about it for accountants used to reading financial reporting standards. As an ED it also clearly identifies the extent of change from *IFRS for SMEs* and what might be expected in the future. This also is helpful.

Question 2: Description of NPOs and users of INPAG

- a) Do you agree with the description of the broad characteristics of NPOs? Does the term ‘providing a benefit to the public’ include all entities that might be NPOs? If not, what would you propose and why?
- b) Does Section 1 together with the Preface provide clear guidance on which NPOs are intended to benefit from the user of INPAG? If not, what would be more useful?

- a) The broad characteristics definition is helpful as the NPO sector is diverse both in specific countries and also between countries, where regulation may segregate specific NPOs from others and legislation focuses on different aspects of NPOs (Cordery & Deguchi, 2018). The INPAG ED’s definition allows for professional judgment by preparers (and auditors), and also provides a way that policy-makers can identify which NPOs they may wish to require to use INPAG.

The term ‘providing a benefit to the public’ works because it is in tandem with the requirement that direct surpluses are for the benefit of the public (rather than private) and that the entity is not in the public sector. The Application Guidance also usefully explains these concepts further. In New Zealand we considered whether taking a narrow view of the public (i.e. excluding those entities that served a group who were generally related to each other or, for example cared for those with a rare disease) could in itself take away the right to claim a public benefit (see <https://www.charities.govt.nz/ready-to-register/need-to-know-to-register/charitable-purpose/public-benefit-and-charitable-purpose/>). IG1.5-6 also provides further guidance. On balance and particularly when those individuals are not named in the founding documents as beneficiaries, it was agreed that the size/breadth of ‘the public’ should not constrain such a claim. This is the reason for concurring with INPAG.

- b) Yes.

Question 3: Concepts and Pervasive Principles

- a) Do you agree with the range of primary users and the description of their needs? If not, what would you change and why?
- b) Do you agree with the qualitative characteristics of useful information? If not, what would you change and why?
- c) Do you agree with the components of net assets? If not, why not?
- d) Do you agree with the inclusion of equity as an element? If not, what would you propose and why? What type of equity might an NPO have?
- e) Do you agree with the categorisation of funds between those with restrictions and those without restrictions in presenting accumulated surpluses and deficits? If not, what would you propose and why?
- f) Do you agree that funds set aside from accumulated surpluses for the holders of equity claims can be part of funds with restrictions and funds without restrictions and that they should be transferred to equity prior to distribution? If not, what do you propose and why?
- g) Do you agree that 'service potential' should be introduced into Section 2? If not, why not?
- h) Do you agree that the provisions for undue cost and effort used in the IFRS for SMEs Accounting Standard should be retained? If not, why not?
- i) Is the NPO as a reporting entity clear? Does the process for identifying branches in the Application Guidance support the principles? If not, what would be more useful?

- a) Yes. The categories (resources providers and the public that depend on the goods and services provided) cover a multitude of different stakeholders that is appropriate for general purpose financial reports (GPFR). NPOs should be encouraged to consider alternative means to reach specific groups of stakeholders (e.g. through summary reports, informative non-financial reporting, etc) but this is not the purview of mandatory GPFR.
- b) Yes. The qualitative characteristics are useful and have stood the test of time in other conceptual frameworks and standard-setting environments. Constraints are also helpful in considering what to recognise, measure and report.
- c) Yes. Net assets are important to ensure that the accounting equation balances for double entry.
- d) Equity is a necessary term in the context of identifying any ownership interest. As noted, NPOs seldom form entities with definable equity instruments (Cordery et al., 2017; Weisbrod, 1986). Nevertheless, López-Espinosa, Maddocks, and Polo-Garrid (2012) found equity definitions most useful (for cooperatives) when they were not tied to ownership, but recognised the various ways that equity could be built in for-profit and non-profit cooperatives using a wide variety of instruments. Hence, retention of the term 'equity' allows for equity to be reported separately from retained earnings.
- e) While in New Zealand we do not encourage fund accounting, I note that those surveyed by Crawford et al. (2014) strongly encouraged guidance on fund accounting. Where these funds exist, it is necessary to identify those with externally-imposed restrictions and those without. This should not include reserves categorised by those in governance for a particular purpose.

- f) Where such restricted funds are held over period end, they should be held separately in equity/net assets, rather than as a liability.
- g) Yes. The role of service potential has been recognised by numerous standard setters over many years as the expectation that a resource will be held for its ability to enable the entity to meet its service objectives, rather than being held for a financial return. I agree with this inclusive nature of the definition of an asset.
- h) Yes. Standard-setters find it difficult to assess the costs and benefits of their pronouncements and this clearly signals that when the balance has tipped too far in the cost direction, an NPO may consider the impact of not disclosing and item to its users. It is very clear that this is an exception and that in most cases such non-disclosure should be reported.
- i) Good advice is given to ensure thoughtful consideration of the boundary of an entity. The notion of control (in Section 9) is important, even though many NPOs find it difficult to ascertain the nature of some of their relationships. I wonder if a further indicator should be added at AG2.19 of ‘using the same regulatory number (e.g. tax number, charity registration number)’ may help in NPOs thinking about their relationships?

It also might be helpful to clearly state that the word ‘branches’ covers ‘schemes’, ‘subsidiaries’, ‘branches’, ‘divisions’, ‘accredited members’, ‘constituents’, ‘regional organisations’ etc, while acknowledging that while these may be controlled, these activities may be quite independent of one another. IG2.9 onwards provide useful assistance for preparers in this regard.

Also note that G2.47 appears to have a word missing?

Question 4: Principles to enable comparability of financial statements

- a) Do you agree with the proposed changes to terminology from the IFRS for SMEs Accounting Standard? If not, what would you propose and why?
- b) Do you agree that comparatives should be shown on the face of the primary statements? In particular, do you agree with the proposed comparatives for the Statement of Income and Expenses? If not, what do you propose and why?
- c) Do the proposals for expressing compliance with INPAG create unintended consequences? If so, what are your key concerns?

- a) Generally, yes. I recommend that the term ‘Objective of financial statements’ be changed to ‘Objective of financial reports’, or better still, ‘Objective of General Purpose Financial Reports’, given the inclusion of non-financial reporting as essential to communication with users.
- b) Yes. Although para 3.10 may suggest that preparers can adopt policies or principles that are at odds to this guidance. I suggest that the last sentence of this clause states ‘In these cases, as well as meeting the requirements of INPAG, the inclusion of additional disclosures or explanation may be necessary to satisfy the characteristics of comparability’.
- c) I am unaware of any.

Question 5: Scope and presentation of the Statement of Financial Position

- a) Do you agree that all asset and liability balances should be split between current and non-current amounts (except where a liquidity-based presentation has been adopted)? If not, why not?
- b) Do you agree with the proposal that not all categories of asset and liability balances should be split between those with and those without restrictions? If not, which categories of asset and liability should be split?

- a) Yes. However, Para G4.5 appears to redefine current assets as ‘held for the purpose of its operating activities’. It is not clear that this is the same as *IFRS for SMEs*’ definition of ‘primarily for the purpose of trading’ (IASB, 2015, para. 4.5b) and it could suggest that non-current property, plant & equipment used for operating.
- b) Yes. Further, the application guidance is useful to enable judgment on particular NPOs’ circumstances.

Question 6: Scope and presentation of the Statement of Income and Expenses

- a) Do you agree with the name of the primary statement being ‘Statement of Income and Expenses? If not, why not?
- b) Do you agree that the terms surplus and deficit should be used instead of profit and loss? If not, why not?
- c) Do you agree that amounts on each line of revenue and expenses should be split between those with and without restrictions on the face of the primary statement? If not, what alternative approach would you propose and why?
- d) Do you agree that NPOs should be able to choose whether to present either income items or expense items first to get to a surplus or deficit? If not, what alternative approach would you propose and why?

- a) I would prefer it was called a ‘Statement of Financial Performance’, especially given the allocation to non-controlling interest and holders of equity claims. This would suggest it is more than merely the income and expenses during a period but the financial performance achieved by the entity which is reporting. It does not mean that the only performance of an NPO is financial, but enables users to further differentiate this statement/ from a statement of non-financial performance (as outlined in section 35 of INPAG).
- b) Yes.
- c) Yes, as per my comment above.
- d) Yes.

Question 7: Scope and presentation of the Statement of Changes in Net Assets

- a) Do you agree with the proposal that there is no Other Comprehensive Income (OCI), and that an expanded Statement of Changes in Net Assets would allow an equivalent to the OCI being produced. If not, why not?
- b) Do you agree that funds were split between those with and those without restrictions on the face of the primary statement? If not, what alternative approach would you propose and why?

- a) Yes. This enables simpler reporting while the Statement of Changes in Net Assets means that the important information continues to be disclosed. The use of the term 'net assets' is in line with the limited owners' equity in NPOs.
- b) Yes, per my comment above.

Question 8: Scope and presentation of the Statement of Cash Flows

- a) Do you agree with the separate presentation of cash donations and grants on the face of the statement? If not, what alternative approach would you propose and why?
- b) Do you agree that donations and grants received for the purchase or creation of property, plant and equipment should be treated as investing activities? If not, what alternative would you propose and why?
- c) Do you agree that both the direct method and indirect methods for the cash flow statement should be permitted? If not, why not?

- a) Yes. Cash donations and grants are important components of many NPOs' revenue (Cordery et al., 2017) and this change is one of many examples of where INPAG provides useful structure and guidance to NPOs. The Application Guidance on non-cash donations (at AG7.1) is also useful.
- b) Yes, they are clearly not part of operational cash flows.
- c) Yes. This is also the approach of the IFRS for SMEs (IASB, 2015) and allows entities choice when they are not publicly accountable.

Question 9: Principles underpinning the notes to the financial statements

- a) Do you agree that there are no NPO specific considerations for this Section? If not, what do you propose and why?

- a) Yes, especially with the relevant terminology changes.

Question 10: Approach to consolidated and separate financial statements

- a) Is the Application Guidance to apply control principles sufficient? If not, what changes or additions would you propose and why?
- b) Do you agree that a rebuttable presumption relating to control should be retained? Is the current drafting sufficient? If not, what additions would you propose and why?
- c) Is the Application Guidance sufficient to apply the fundamental characteristics of faithful representation and relevance to consolidation? If not, what additions would you propose and why?
- d) Do you agree with the use of the terms ‘controlling entity’, ‘controlled entity’ and ‘beneficial interest’ instead of ‘parent’, ‘subsidiary’, and ‘investment’? If not, what would you propose and why?

- a) This is a vexed area as, while NPOs enjoy relationships with other not-for-profit organisations, the nature of these relationships can be unclear. The guidance on power, returns, and their interlinking should help to clarify the meaning of control for NPOs. (Despite my comment at Question 3 i), I obviously do not believe that a single registration number (tax, regulator etc) should be an indicator of control.)
- b) Yes. It would also be helpful if the glossary included a definition of the term ‘rebuttable presumption’ which is seldom used in everyday life and yet is used in at least three sections of INPAG.
- c) Yes.
- d) Yes.

Question 11: Approach to accounting policies, construction of estimates and accounting for errors

- a) Do you agree with the updates made to Section 10 and that there are no additional NPO specific considerations that need to be addressed in this Section? If not, what changes or additions would you propose and why?

- a) Yes.

Question 12: Scope and content of narrative reporting

- a) Do you agree with the principles proposed to underpin narrative reporting? If not, what would you propose to change and why?
- b) Do you agree with the scope of the minimum mandatory requirement, with additional information, such as sustainability reporting to be optional? If not, what changes should be made and why?
- c) Do you agree with the proposals that sensitive information can be excluded from narrative reports? If not, what alternative would you propose and why?
- d) Should a two-year transition period for narrative reporting be permitted to assist in overcoming any implementation challenges? If not, what approach would you propose and why?

- a) Yes. These are drawn from the qualitative characteristics and it is good to remind preparers and users of these.
- b) Yes. While the guidance sets a principle for narrative reporting to be 'fair and balanced', NPOs need to be reminded of this and not to overload users by too much (irrelevant) disclosure. This may result in important information (positive or negative) being hidden from those users. Our experience in New Zealand is that NPOs may have difficulty in choosing a good balance of information and may disclose too much information, or focus on positive information only. Guidance in G35.21-24 (and AG35.4 and IG35) to remember user needs and to enable cross-referencing to external information help in this regard. Yet I believe this principle could be further underlined and to include the reason for it, to make narrative performance reporting a useful combination with financial performance.
- c) Yes.
- d) No. The requirements of this section should not be difficult to comply with. In analysing four jurisdictions (Australia, NZ, the UK and US), McConville and Cordery (2018) found that where performance reporting was mandated (at that stage only the UK), charities reported more relevant narrative information, more 'bad news', as well as providing more information to allow these data to be verified (i.e. explanations of how different measures were calculated). Even though the SORP has quite a 'soft' requirement, it positively impacts the information disclosed to users, as will INPAG. The sooner it is placed the better.

References

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