Think Ahead ACCA

# ED CIPFA/ED/2022/1 International Non-Profit Accounting Guidance Part 1

Exposure draft issued by the CIPFA in November 2022

Comments from ACCA
31 March 2023

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ACCA
+44 (0)20 7059 5000
info@accaglobal.com
www.accaglobal.com
The Adelphi 1/11 John Adam Street London WC2N 6AU United Kingdom

Further information about ACCA's comments on the matters can be requested from:

Hsiao Mei Chow
Senior Subject Manager – Corporate Reporting and Tax
hsiaomei.chow@accaglobal.com

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# OVERALL COMMENTS

ACCA welcomes the opportunity to provide views in response to CIPFA's Exposure Draft CIPFA/ED/2022/1 International Non-Profit Accounting Guidance (INPAG) Part 1 (hereinafter referred to as 'ED1'). This response has been drafted with the assistance of ACCA's Global Forum for Corporate Reporting.

We note that non-profit organisations (NPOs) and users of their financial statements have expressed a need for an alternative to existing established financial reporting frameworks to cater to NPO-specific needs, and that INPAG aims to provide that alternative. We appreciate the efforts that have gone into this project, and provide our comments below on areas which we consider most important or where we have perspectives to add.

**Status, purpose and authority of INPAG need clarification**

We consider that the status of INPAG needs clarification as to whether it is guidance or a standalone standard. In its current form, INPAG appears to be branded as guidance but has been drafted as a standard, developed using three international financial reporting frameworks, i.e., the full IFRS Accounting Standards, the *IFRS for SMEs* Accounting Standard, and the International Public Sector Accounting Standards (IPSAS). [ED1.GP8]

We further observe that ED1.GP23 specifies that all the paragraphs in INPAG have equal authority. However, ED1.GP24 explains that INPAG includes authoritative core text (referred to as 'Core Guidance' in the Invitation to Comment), supported by the authoritative Application Guidance and non-authoritative Implementation Guidance.

The term 'guidance' is typically associated with reference materials provided to assist understanding in implementing requirements set out in a standard. INPAG's use of the term 'guidance' with different levels of authority creates confusion about how these different parts of INPAG should interact with one another.

In addition, we think that clarity is needed on whether full compliance with INPAG also means that full compliance with the Application Guidance and Implementation Guidance is required. If this is not the case, the current naming convention may inadvertently result in the contents of the Implementation Guidance being misconstrued as requirements rather than as non-authoritative illustrative examples, which can lead to the INPAG seeming rule-based rather than principle-based. While we support the proposal for a NPO to make an explicit and unreserved statement of compliance with INPAG in the notes to the financial statements, we have concerns that claiming compliance will be difficult until the abovementioned challenges are resolved.

## Preconditions of an audit need to be met

We believe that INPAG in its current ambiguous form raises doubts on whether it meets the preconditions for an audit, and hence, may not provide a suitable basis for auditors to determine compliance. For the purpose of this comment, we refer specifically to general purpose financial statements, as this is the intended focus of INPAG. [ED1.G1.2, G2.5-G2.6]

To establish whether the preconditions for an audit are present, the auditor shall determine whether the financial reporting framework to be applied in the preparation of financial statements is acceptable. While in many cases the auditor may presume its acceptability, this is provided that the standards were established by an authorised or recognised standard setting organisation following an established and transparent process involving deliberation and consideration of the views of a wide range of stakeholders. Other factors relevant to the auditor's determination of the acceptability of the financial reporting framework include whether law or regulation prescribes the applicable financial reporting framework. [ISA 210.6(a), A3, A4, A8]

We note from ED1.GP21 that decisions on which entities are required or permitted to use INPAG rest with legislative and regulatory authorities and standard setters in individual jurisdictions. In this respect, more clarity is needed about current and/or planned efforts towards advocating and supporting adoption of INPAG in more jurisdictions. Taking ISA 210 into consideration, the absence of endorsement for adoption of INPAG in national or regional jurisdictions will add a compliance burden to NPOs and their auditors as the latter will need to perform rigorous assessments on the acceptability of INPAG in satisfying the preconditions for an audit. This may discourage the application of INPAG.

In addition, stakeholders and regulators of NPOs will likely require the audited financial statements of NPOs to be prepared based on an international financial reporting framework or equivalent national Generally Accepted Accounting Practice (GAAP) that are endorsed or recognised by them. Therefore, NPOs may be discouraged from applying INPAG to avoid additional reporting burden.

## Project longevity and long-term maintenance of INPAG needs more certainty

We note from ED1.GP25 that there are longer term plans for amendments to INPAG, which will include consideration of amendments to the *IFRS for SMEs* Accounting Standard, new and amended IFRS Accounting Standards, IPSAS and jurisdictional-level standards. However, we also note that this project is currently still actively seeking funding, following the initial seed funding from two major Foundations.

In this respect, we support and commend the planning for INPAG's future maintenance, as we believe that as much alignment as possible with international financial reporting frameworks, on as timely a basis as possible, is crucial to maintain comparability and facilitate users' understanding of the financial statements prepared, as well as facilitating NPOs' access to funding.

At the same time, we have concerns that NPOs in a jurisdiction that does not permit or require the adoption of INPAG would not be able to assert compliance with INPAG. An NPO that is transitioning to INPAG also cannot assert compliance until it fully complies with INPAG. This may reduce the attractiveness of INPAG until it is recognised or endorsed by more jurisdictions that permit or require the adoption of INPAG.

In this regard, we think more clarity and certainty is needed as to how the long-term plans for this project will be achieved, including plans for achieving endorsement by national and regional standard setters, since these will only be possible with sufficient, continuous funding and resources, supported by a robust governance structure.

**Alignment with the final version of the *IFRS for SMEs* Accounting Standard should be maximised**

We observe that references in INPAG to the *IFRS for SMEs* Accounting Standard currently refer to the Exposure Draft of the Third edition of the *IFRS for SMEs* Accounting Standard, the consultation period of which has been largely concurrent with that of INPAG. In this regard, we recognise the merits of considering updates and amendments to the *IFRS for SMEs* Accounting Standard (and other international financial reporting frameworks) on a case-by-case basis as to whether they should be incorporated into INPAG. We strongly encourage maximum alignment with the final version of the *IFRS for SMEs* Accounting Standard prior to finalising INPAG, unless departure from any requirement is absolutely necessary to accommodate the needs of NPOs and users of their financial statements.

**Description of NPOs and users of INPAG**

**Use of INPAG should be clearly limited to entities without public accountability**

The Invitation to Comment indicates that although an entity might be described as an NPO, INPAG is not intended to apply to very small NPOs where cash-based financial information might be sufficient, or those NPOs that meet the definition of public accountability in the IFRS Accounting Standards. ED1.BC 1.1 confirms that more complex organisations in the latter category need to follow full IFRS Accounting Standards, or equivalent national GAAP, though INPAG may provide useful guidance for NPO-specific transactions.

If INPAG is intended to be a complementary guidance to existing international financial reporting frameworks, claiming full compliance with INPAG requirements and the assertion thereof could directly result in an entity’s non-compliance with the full IFRS Accounting Standards, IPSAS and *IFRS for SMEs* Accounting Standard. This will effectively discourage the use of INPAG in jurisdictions which require eligible entities’ compliance with those standards, despite INPAG’s potential to address NPO-specific needs. We are mindful that NPOs, which are likely to be already pressed for resources, will instead have an increased reporting burden if they are expected to prepare separate, multiple sets of financial statements/information using different financial reporting frameworks. Ultimately, we believe that NPOs’ resources are best used on providing benefit to the public.

We note that ED1.G1.2 clearly scopes out government or public sector entities from using INPAG. In addition, ED1.G1.6–12 set out requirements for use of INPAG by entities that have public accountability, with disclosures required to explain why the use of INPAG meets the needs of users of its financial statements. ED1.AG3.2 adds that any NPO that has public accountability can use INPAG to assist in preparing its financial statements, albeit cautioning that the NPO is unlikely to be able to assert a fair presentation in accordance with INPAG. These statements bring ambiguity by giving the overall impression that entities with public accountability have the option to use INPAG in preparing their general purpose financial statements, which contradicts the Invitation to Comment and Basis for Conclusions.

If INPAG is intended to be a standalone standard, we are strongly of the view that INPAG should emulate the *IFRS for SMEs* Accounting Standard and clearly scope out entities that carry public accountability in ED1.G1.2. For example, 'do not have public accountability' should be one of the broad characteristics describing NPOs for the purpose of applying INPAG. This is particularly in view that the *IFRS for SMEs* Accounting Standard, which is clearly dedicated to entities without public accountability, is the foundational framework of INPAG. Also, the undue cost or effort exemption for some requirements is typically not available for application by entities with public accountability.

As such, we reiterate that the status of INPAG needs clarification as to whether it is a guidance or a standalone standard.

**Indicators that an entity might be an NPO should be further refined**

The indicators set out in ED1.AG1.2 are helpful in complementing INPAG's broad characteristics-based approach in identifying an NPO. However, we suggest that the first indicator be further enhanced to read:

> '*An absence of individuals, <u>or groups of individuals,</u> with rights, <u>directly or indirectly,</u> to financial returns from surpluses.'*

**Key concepts and principles**

**Changes to existing terminology should be minimised**

We appreciate that INPAG proposes to replace certain terminology used in the *IFRS for SMEs* Accounting Standard to be more appropriate for the NPO context. However, we strongly recommend that such changes be kept at a minimum. Use of consistent terminology will better encourage adoption, and ease transition and implementation. Such variations, though seemingly minor, have the potential to increase the risk of unintended consequences, creating confusion, compromising comparability of financial information and leading to divergence in practice.

In this regard, we consider that:

a) the term ‘parent’ should be retained and not replaced with ‘controlling entity’ or ‘controlling NPO’. Other variations noted in INPAG include ‘controlling NPO (parent) entity’ and ‘controlling NPO entity’, which can cause confusion.

   In addition, retaining the term ‘parent’ would be consistent with the Exposure Draft of the Third edition of *IFRS for SMEs* Accounting Standard which proposes to remove use of the term ‘controlling entity’.

b) the term ‘subsidiary’ should be retained and not replaced with ‘controlled entity’. This risks confusion with the term ‘jointly controlled entity’.

c) the term ‘beneficial interest’ should not be used interchangeably or as a replacement for the term ‘investment’. The Glossary of terms specifies that ‘beneficial interest’ arises other than through equity ownership. We further note that NPOs can have a variety of different legal structures, and that this term cannot replace all uses of the term ‘investment’ in Section 9 of INPAG.

Notwithstanding the above, we have no objection to introducing the term and concept of ‘service potential’ into INPAG as this reflects NPOs’ characteristics. The service potential of an asset is more important than generating cash flows in the NPO context. Accordingly, this should be a concept separate from ‘economic benefits’. [ED1.G2.54]

**Consolidated and separate financial statements**

**Rebuttable presumption relating to control needs clarification**

We agree with retaining the rebuttable presumption relating to control in ED1.G9.18. However, ED1.G9.18 as currently drafted may be interpreted as requiring an NPO with the majority of the voting rights of an entity to assess whether it does not have one or more of the elements of control listed in ED1.G9.9. This interpretation would render the rebuttable presumption to be of less value to NPOs.

We suggest clarifying if an NPO that holds a majority of the voting rights in an entity is still required to consider the three criteria in ED1.G9.9. Alternatively, we suggest explaining the circumstances that will require an entity to reassess if it has control. This explanation will also be helpful for applying the requirements of ED1.G9.10.

Since ED1.G9.9 and ED1.G9.18 are closely aligned to paragraphs 9.4B and 9.5 of the Exposure Draft for the Third edition of the *IFRS for SMEs* Accounting Standard, we wish to reiterate our recommendation for the relevant paragraphs in INPAG to be aligned with the final version of the *IFRS for SMEs* Accounting Standard prior to finalising INPAG.

**Requirement relating to loss of control needs refinement**

We observe that ‘former controlled entity’ is used throughout ED1.G9.32, except in subparagraph (c). We note also that this wording follows that of IFRS 10. For simplicity and to ease NPOs’ understanding, we suggest that subparagraph (c) be reworded as ‘recognises the surplus or deficit associated with the loss of control of the former controlled entity.’ However, in the event that our earlier comment regarding retention of the term ‘subsidiary’ is adopted and incorporated into the final INPAG, we recommend that the term ‘subsidiary’ be used throughout ED1 instead of ‘controlled entity’.

**Relevance of gain or loss disclosure following loss of control needs to be considered**

While we agree with disclosing the gain or loss when an NPO loses control of its controlled entity (i.e., ED1.G9.42), we suggest reconsidering the relevance of ED1.G9.42(a) to users of NPO financial statements. ED1.G9.42(a) requires an NPO to disclose the portion of gain or loss attributable to the retained interest in a former controlled entity at the date when control is lost. Users may benefit from knowing the entire gain or loss when an NPO loses control of a controlled entity, which is a non-recurring event, and the amount is not readily identifiable. However, the incremental benefit from further analysing this gain or loss amount into the portion for retained interest may be disproportionate with the effort required to perform this analysis.

**Narrative reporting**

**Sustainability and financial reporting need to be coherent and connected**

We believe that good quality reporting should cover a wide range of value drivers for entities, beyond financial performance and position but equally beyond environmental or social impact. In this regard, our paper sets out the ‘Principles for connected corporate reporting’ which we believe will be helpful in finalising INPAG.

Further, we commend the effort in including an entire Section 35 dedicated to narrative reporting. Given recent fast-paced developments in sustainability reporting, we think NPOs will likely benefit from providing sustainability information, particularly if the information complements the sustainability reporting of donor or sponsor organisations. There is also likely to be overlap between the ‘performance information and financial statement commentary’ to be reported in Section 35 and the requirements in IFRS Sustainability Disclosure Standards. Having said that, not all NPOs will have the resources to provide narrative reporting or report on sustainability information. Hence, we do not support making narrative reporting mandatory for NPOs.

Meanwhile, we note that ED1.G35.30 permits an NPO to choose or be required to present additional information in its general purpose financial report beyond the performance information and financial statement commentary included Section 35. In this regard, we suggest closely monitoring and reviewing how INPAG shall interact with the IFRS Sustainability Disclosure Standards once the latter are issued.

We also consider that connectivity deserves greater emphasis. As the effect of connectivity cuts across different topics, it should be considered as a qualitative characteristic that will enhance the usefulness of information. It will also complement the existing qualitative characteristics of comparability, verifiability, timeliness and understandability.

However, care is needed to ensure that connectivity in reporting is not defined narrowly. It has to connect financial information with non-financial information, quantitative information with qualitative information, and connect different sections of a report together in a presentational sense. In addition, it is important to connect externally-reported information with information used internally for decision-making.

**Exception to disclose sensitive information should be in limited circumstances**

We acknowledge that circumstances can arise which necessitate the use of ED1.G35.7 which provides an exception to minimum narrative reporting requirements when the information is sensitive and/or could prejudice the ability of the NPO to deliver its mission, and we commend the clarification provided in ED1.IG35.4-6.

However, we recommend that ED1.IG35.5 should be presented immediately after ED1.G35.7 as it clarifies that the relief is reserved solely for situations where disclosure would jeopardise the safety and security of staff, volunteers or the public that benefit from the goods and services provided by the NPO. This important clarification should not reside in the Implementation Guidance which is described as non-authoritative. This paragraph also deters the misuse of this relief, e.g., as a way to hide poor performance or financial problems that may have arisen with aspects of an NPO's operations. On the other hand, if the relief is intended for more circumstances beyond those affecting the safety and security of staff, volunteers, or the public, we suggest assessing if information is sensitive according to a set of principles. The principles will support verifiability during audit and/or supervision by regulators.

We also support the requirement to disclose that the narrative report has been prepared in accordance with the requirements of the sensitive information exemption paragraph when this exception is availed of.