

Practitioner Advisory Group

Issue Paper

AGENDA ITEM: PAGED04-01
15 November 2021 – Online

Consultation Paper responses and potential changes to approach

Summary	This paper provides an overview of some of the key themes that have emerged from responses to Part 1 of the Consultation Paper, and the support for the Issues chosen and alternative treatments highlighted in Part 2 of the Consultation Paper. Initial views from the Secretariat as to how these may be responded to and potential changes to approach for the Exposure Draft.
Purpose/Objective of the paper	To understand the key themes emerging from responses and to provide views on how the Secretariat proposes to respond to a number of specific issues.
Other supporting items	Not applicable
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Actions for this meeting	<u>Comment</u> on the key themes that have emerged <u>Provide input</u> on the specific issues raised.

Practitioner Advisory Group

Response to the Consultation Paper and potential changes to approach

1. Background

- 1.1 PAG will be aware that the Consultation Paper was published on 28 January 2021, with a deadline for responses to Part 1 of 30 July 2021 and Part 2 of 24 September 2021. In total, following a brief deadline extension for both Parts, 89 responses were received for Part 1 and 69 for Part 2.
- 1.2 The Secretariat has undertaken a detailed analysis of Part 1 responses. The Part 2 - Overview responses have also been examined in detail, while for the individual Issues in Part 2 analysis to date has so far been restricted to understanding which alternative treatments were supported by respondents. Detailed analysis of individual issues will be undertaken on an issue by issue basis in accordance with the workplan.
- 1.3 This paper provides an overview of some of the key themes that have emerged. Advice is sought from PAG members on a number of specific issues in relation to how the Secretariat proposes to respond to the issues raised by respondents. This may potentially change the approach for the Exposure Draft. It also provides PAG members with detail on which alternative treatments were supported for each Issue in Part 2, and potential changes to Issues that might be covered in the first stage of the project for which PAG member advice is requested.

2. Part 1: Key themes

- 2.1 Respondents provided significant levels of support to the proposals contained within Part 1 of the Consultation Paper. The full analysis was provided to the PAG in October and is available [TAGED03-01 Analysis of Part 1.pdf \(humentum.org\)](https://www.humentum.org/TAGED03-01%20Analysis%20of%20Part%201.pdf).
- 2.2 There are three areas where feedback to the Consultation Paper would indicate that a change in approach may be required for the Exposure Draft and where advice from PAG members is sought.

- 2.3 These areas are:
- (i) Update to the broad characteristics approach;
 - (ii) Defining the primary users of NPO General Purpose Financial Reports;
and
 - (iii) Identifying the target audience for the Guidance.

Updates to the broad characteristics approach

- 2.4 The broad characteristics approach to describing the entities that the Guidance is being developed for was widely supported by respondents. Some did note though that the characteristics could have unintended consequences in terms of the scope of the entities covered by the Guidance. For example, respondents indicated that under the proposed broad characteristics private hospitals might potentially be included, and grant-giving organisations excluded.
- 2.5 Discussion with TAG members has supported additional work on the broad characteristics to respond to these issues raised, with a general consensus that they need to be expansive given global diversity and the fact that ultimately it will be for individual jurisdictions to determine which entities apply the Guidance.
- 2.6 The Secretariat has looked again at the broad characteristics and believes there may be a case for reducing the number of broad characteristics to two, with entities expected to demonstrate both to be described as NPOs. Additionally, indicators would be introduced to assist in determining whether the entity is within the intended scope of applicability of the Guidance where further clarity is needed.
- 2.7 Under this new approach NPOs will be described as entities that:
- Have the primary objective of providing goods and/or services for public benefit; and
 - Direct profits/surpluses for public benefit.
- 2.8 There is a question as to what counts as 'public' in 'public benefit'. In particular the extent to which this can be restricted to sections of the public or even to members of an organisation.
- 2.9 The primary objective of an NPO will be to provide goods and services to the general public, community or for wider societal benefit and not to generate a private benefit for providers of resources. The goods and services provided by NPOs are diverse. They can range from items like medical supplies and humanitarian relief to advocacy services and the protection of the natural

environment. What is common to all of these goods and services provided by NPOs, however, is that they will benefit the public in general, or at least a sufficient section of the public, and not give rise to private benefits such as financial returns to those providing resources to the entity.

- 2.10 Depending on the nature of the goods and services provided by the entity, the view of the Secretariat is that what counts as a sufficient section of the public befitting from the NPOs activities could be quite limited, and even restricted to a defined membership of the entity. This will not preclude an entity from being described as an NPO but, where the section of the public benefitting from the goods and services is limited in this way, then it is likely that further consideration of other indicators would be needed to determine if the entity is indeed an NPO.
- 2.11 There may also be questions around directing profits/surpluses for public benefit. While distributing financial returns to equity holders through dividends would be a relatively clear indication that an entity is unlikely to be an NPO, there are other benefits that an NPO can provide that would also require further consideration. These include for example, if a membership entity were to provide discounted goods and services to its members.
- 2.12 Where it is not clear if an entity fully displays the broad characteristics, other indicators could be used to assist in determining whether the entity is within the intended scope of applicability of the Guidance.
- 2.13 It is proposed that these other indicators would be:
 - **Rights to financial returns and transfer of residual net assets upon dissolution** – an absence of individuals having defined rights to financial returns and a requirement that upon dissolution of the entity any residual net assets have to be transferred to an entity with a similar purpose;
 - **Voluntary funding** - the provision and receipt of voluntary funding through donations, grants or volunteering of services may be significant to the entity; and
 - **Purpose and use of assets** - assets will be held primarily to assist in delivering goods and/or services for public benefit and not to generate financial returns to providers of resources.

Questions

1. What are the PAG's views on reducing to two characteristics that must both be present?
2. What are the PAG's views on the additional indicators? Do they all need to be present?
3. What are the PAG's views on the term 'public benefit' as it is used in these characteristics

Defining the primary users of NPO General Purpose Financial Reports

- 2.14 Feedback obtained from respondents indicated that there was a need to examine stakeholder groups, with a view to integrating 'internal' stakeholders and other similar groups where appropriate. Respondents also noted that it was necessary to determine who the primary users of NPO GPFRs are so that their financial and non-financial information needs, specifically with reference to GPFRs, could be articulated.
- 2.15 Discussion with TAG members supported work in these areas. With respect to 'internal' stakeholders there was a general consensus that a non-executive board or similar body charged with oversight could be seen as an 'internal' stakeholder that might be a primary user of the NPOs GPFRs. However, it was felt this should not be extended to other internal stakeholders such as staff. This is because TAG members did not see staff as primary users of GPFRs. There was also discussion as to the extent to which regulators might be primary users, particularly as they were usually in a position to demand information on their own terms outside of what would generally be seen as GPFR.
- 2.16 Under the broad characteristics proposed, NPOs are entities that provide goods and services for the public benefit, and direct financial surpluses to furthering their public benefit objectives. This description of NPOs would indicate that NPOs are accountable for their management and use of resources to those that provide them with resources, and to those that depend on them to use those resources to provide goods and services.
- 2.17 The objectives of financial reporting by NPOs are to provide information about the entity that is useful to users of GPFRs for accountability and decision-making purposes. The Secretariat therefore proposes that primary users of NPO GPFRs include resource providers and the public to whom the NPO provides goods and services.

- 2.18 As indicated from responses to the Consultation Paper and discussion with the TAG, it is recognised that the interests of resource providers and the public to whom the NPO provides goods and services are often in practice upheld by groups fulfilling non-executive oversight functions. Some of these groups may be considered ‘internal’ to the NPO, for example non-executive boards responsible for challenging and holding the executive of an NPO to account.
- 2.19 Others providing non-executive oversight functions may include individuals or groups that are external to the entity. This will include public officials and elected representatives who protect the interests of those to whom they have a duty of care and/or their constituents.
- 2.20 Those providing non-executive oversight functions, be they ‘internal’ to the NPO such as non-executive boards, or external to the NPO such as elected representatives may therefore also be seen as primary users.
- 2.21 For the purpose of the Exposure Draft and Guidance development, the Secretariat proposes that GPFRs of NPOs will be developed primarily to respond to the information needs of the public to whom the NPO provides goods and services, resource providers, and those fulfilling non-executive oversight functions on their behalf, **who do not possess the authority to require an NPO to disclose the information they need for accountability and decision-making purposes.**
- 2.22 Donors and regulatory bodies such as tax authorities are likely to have the authority to require the preparation of financial reports tailored to meet their own specific information needs. At the same time as requiring specific financial reports, donors and regulatory bodies may find the information provided by GPFRs useful and utilise it for their own purposes.
- 2.23 It is the Secretariat’s view that GPFRs are not developed specifically to respond to any donor or regulatory bodies particular individual information needs, which as noted they may have the authority to require an NPO disclose. Donors and regulatory bodies will however as collectives be primary users of GPFRs when not making use of this authority. In these situations they will be acting like other resource providers or providers of oversight.

Questions

4. What are the PAG's views on non-executive boards being a primary user? Does the PAG have views on whether any other 'internal group' should be considered primary users
5. What are the PAG's views on whether donors are a primary user in the context noted?

Identifying the target audience for the Guidance

- 2.24 There was some uncertainty amongst respondents as to which NPOs the Guidance was expected to cover, with a wide range of respondents asking whether consideration had been given to the creation of reporting tiers which would also enable Guidance (potentially on the basis of modified cash or cash) to be provided to NPOs with less burdensome reporting needs.
- 2.25 With respect to the applicability of the Guidance, whether all or some of the Guidance will be optional or mandatory for an entity will ultimately be the decision of individual jurisdictions. At present, as was noted in the Consultation Paper, the Guidance is intended for use by all NPOs. The focus of the development of the Guidance initially though is on NPOs with relatively complex operations and transactions and/or jurisdictional or international level service delivery or funding characteristics that are driving reporting burdens.
- 2.26 Reporting 'tiers' are not at present being pursued by the project and the TAG were strongly of the view that Guidance issued by this project should not be tiered. Rather it is proposed that careful consideration is given as to how we can ensure proportionate application of accrual-based Guidance given sector constraints in capacity, skills and expertise though the alternatives pursued to the issues covered in Part 2 of the Consultation Paper.
- 2.27 The extent to which tiered Guidance should be considered in the longer term to potentially broaden the scope of entities that could apply the Guidance may though be examined at a later stage subject to resource availability.
- 2.28 PAG members are asked to note the approach proposed.

Question

6. Does the PAG have any views on the proposal for 'proportionate application of accrual-based Guidance', noting that jurisdictions will ultimately decide who the Guidance will apply to?

3. Part 2: Overview of the consultation responses

- 3.1 Annex A provides a summary of the responses to the questions in Part 2 of the Consultation Paper.

4. Part 2: Key issues raised

List of NPO-Specific Financial Reporting Issues

- 4.1 In response to the question about whether the list of NPO reporting issues was complete, there were a variety of different issues suggested by respondents in either agreeing and disagreeing with the list. A number of items were identified as perhaps not needing to be on the list, but also some new topics were proposed.

Table 2: List of changes to the Long List of NPO-specific Financial Reporting Issues

Issue	Comment by respondent	Secretariat response
<i>Items which Potentially Should not be Included on the List</i>		
Accounting for investment/financial assets	Respondent not clear on the issue	Leave on long list until more information is known
Financial reporting of foreign currency transactions	An issue for special purpose financial reports and not GPFs.	Raised as a significant issues and consideration is being given to short list inclusion
Service concession arrangements with NPO as operator	Not NPO specific	Leave on long list until more is known
Service concession arrangements with NPO as grantor	Need to amend the foundational framework to accommodate this.	Leave on long list until more is known



<i>Items which Potentially Should be Added to the List</i>		
Reserves and restricted funds	Information should be provided on sources of funds, purpose, and time period.	Will be incorporated into the issue on financial statement presentation.
Heritage assets	This issue is of reasonably widespread application.	Leave on long list for phase 2.
Related party transactions	Regulatory interventions give rise to conflicts of interest.	Consider inclusion in the short list.
Pensions costs	Should be included on the list given the variety of post-employment benefits.	Add to long list until more is known.
Social impact accounting	Key to NPOs' financial reporting in some countries	Address as part of narrative reporting.
Statement of cash flows	Proper guidance needed to complement accrual based general purpose financial statements.	Consider as part of presentation of financial statement topic.
Grants and Service Contracts	The distinction between grants and service contracts can be difficult at times.	Consider as part of grant expenses topic.
Joint Activities	Do joint activities fit into 'Reporting Entity Issue' because acting together has become much more common?	Consider whether this is a high priority.
Concepts and Pervasive Issues	Inclusion of a section on underlying criteria, names and terminologies as well as aspects of narrative reporting.	Will be incorporated into the development of the guidance

- 4.4 One respondent also commented on the dynamism of the sector and that these issues should be kept under review. The Secretariat concurs with this comment.

Question

7. What are the PAG's views on the response proposed by the secretariat, and in particular views are sought on:
- Whether foreign currency transactions are a matter for general purpose reports?
 - Whether joint activities are a significant issue?

Topics prioritised for the Consultation Paper

- 4.5 48% of 21 individuals that responded to this question agreed that the prioritised list of issues was correct with 52% disagreeing. The reasons for the level of agreement and disagreement varied.

Table 3: List of main items suggested to be included in phase 1

Issue	Respondents Comment	Secretariat response
Related party transactions	Significant impact on public trust and confidence by providing transparency.	Less clear why standards would not be able to provide adequate guidance before the second phase, so proposed as a later phase.
Remuneration/pay disclosures	Important source of information on how NPOs are discharging their governance and accountability obligations.	Less clear that standards or the regulatory frameworks would not be able to provide or already have in place adequate guidance.
Foreign exchange transactions	Material impact on the reporting of many NPOs including fund accounting. This would affect those who are operating in hyperinflationary economies.	This issue was raised very frequently at outreach sessions. Need to be clear whether this is a SPFR or GPFR issue (see earlier). If GPFR potentially include in phase one.
Legacy income	Inconsistency of treatment may affect the decision-making of stakeholders.	Agree that this is an important topic (on long list) but the project has not had significant representations on this topic. So, propose later phase
Simple financial assets, including investments	Consistent recognition and measurement requirements are important to ensure appropriate accountability for funds under an NPO's control.	It is not clear that standards would be unable to provide adequate guidance before a second phase.

Issue	Respondents Comment	Secretariat response
Consolidation	Significant diversity in practice presents accountability challenges.	Not raised as a significant issue during outreach so not proposed as part of a later phase.
Leases	Immediate need to provide guidance for NPOs as a consequence of IFRS16 <i>Leases</i> .	No action until outcome of the review of the <i>IFRS for SMES</i> standard is completed.
Underlying concepts (including measurement and attribution of outputs, accounting reporting framework, report naming and terminology)	The respondent considered these important underlying principles which needed to be in place before providing guidance.	It is proposed that these are included in a Concepts and Pervasive issues section or under Narrative Reporting.

4.6 In addition, there were aspects of narrative reporting that were proposed by respondents including ratio analysis and industry analysis of the organisation.

Question

8. What are the PAG's views on the feedback on prioritisation? What, if any, topics should be elevated to the shortlist?
9. If any topics are added to the shortlist, which of the existing topics should in the PAG's view be deferred to phase 2?

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