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Submission via website: https://www.ifr4npo.org/consultation-paper-response/

Dear Sam,

Submission on Consultation Paper – International Financial Reporting for Non-Profit Organisations (Part 1)

As the representatives of over 280,000 professional accountants, Chartered Accountants Australia and New Zealand (CA ANZ) and CPA Australia thank you for the opportunity to comment on Part 1 of the above Consultation Paper ("the CP"). In providing this feedback, we have used the term not-for-profit (NFP) rather than the term NPO used in the CP, albeit both terms refer to the same types of institutions.

We are strong supporters of the NFP sector and many of our members are involved with the sector in Australia and New Zealand as advisors, auditors, employees and volunteers. New Zealand has almost 115,000 NFP institutions contributing $8.1 billion New Zealand dollars to Gross Domestic Product (GDP) in 2018 and employing 150,000 staff. Although less recent figures are available for Australia, a research report by the Australian Productivity Commission in 2010 identified that there were around 600,000 NFPs operating in Australia at that time. It is understood that approximately 200,000 NFPs are registered for tax concessions with the Australian Taxation Office, of which around 55,000 are registered as charities with the Australian Charities and Not-for-profits Commission (ACNC). The latest Australian Charities Report published by the ACNC in May 2021 identified that the Australian charities sector alone generated revenue of $166 billion Australian dollars in 2019, employing around 1.38 million people, making up 11% of the total employment in Australia.

Given the size of the NFP sectors in Australia and New Zealand, both countries have devoted substantial resources to the creation of reporting frameworks that address the unique characteristics of NFPs and the types of economic activities they undertake. While Australia has modified International Financial Reporting Standards (IFRS) for financial reporting by its NFP sector, New Zealand has modified International Public Sector Accounting Standards (IPSAS) for the same purpose for its larger NFPs. In doing so, both jurisdictions have acknowledged the importance of basing their NFP financial reporting requirements on an internationally recognised framework.

Nevertheless, both the Australian and New Zealand standard setters are keenly aware of the challenges of adapting standards developed for other purposes to the needs of private sector NFPs. As a result, they have needed to invest substantial resources to address challenges that are often similar to those faced in other jurisdictions worldwide.

We therefore support the work Humentum and CIPFA are undertaking to develop internationally applicable guidance for NFPs. It is pleasing to see that the basic building blocks being proposed are broadly consistent with the NFP reporting frameworks that are well established in Australia and New Zealand, and which our experience demonstrates are workable.

While we believe that Part 1 of the CP clearly articulates most of the key principles that need to drive this project, we are concerned that the final scope of the project still remains too vague to enable effective determination of the answers to the specific financial reporting issues (Part 2 of the CP). While the CP suggests that the initial guidance is unlikely to be useful to the smallest and largest NFPs, there is no clear articulation of the boundaries that represent a typical NFP to whom this this guidance will apply. Without a clearer picture of these likely adopters, it will be difficult to synthesise their reporting needs and then ensure those needs are met. We therefore recommend that more work is done to better articulate a description of the primary, likely target audience for these reforms. Such a description would be similar in concept to the IASB's IFRS for SMEs concept of "non-publicly-accountable" entities, which are the intended adopters of that standard.

Further detailed comments to questions raised in the CP are included in **Attachment 1**. We also believe that the project could leverage the extensive body of NFP reporting knowledge that exists within Australia and New Zealand, including the reporting standards for NFPs that exist in both jurisdictions. We have included more detail and background information in relation to this in **Attachment 2**.

If you have any questions about our submission, please contact either Amir Ghandar (CA ANZ) at amir.ghandar@charteredaccountantsanz.com or Ram Subramanian (CPA Australia) at ram.subramanian@cpaaustralia.com.au.

Your sincerely

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Attachment 1

General Matters for Comment 1

Chapter 1: What are non-profit organisations?

1a. Do you agree with the broad characteristics proposed in Chapter 1 for describing NPOs? If not, why not? Which alternative characteristics would you propose, and why?

We consider that, of the four key characteristics proposed, only the first two ("primary objective of delivering services for public benefit" and/or "direct any surpluses to furthering their primary service delivery objective") are fundamental to describing NFPs. While we agree that the proposed third and fourth characteristics ("may have significant voluntary funding" and/or "hold and use assets for social purposes") can also be relevant when identifying an NFP, we do not consider them to be fundamental characteristics. This is because they are usually consequential to activities driven by the primary characteristics.

Therefore, the guidance should be amended such that meeting only the first and second characteristics together is made necessary for an organisation to be considered an NFP. This would mean changing the "and/or" after the first characteristic to "and".

Our rationale for the above suggestion is based on the following definition of an NFP that is currently in use in New Zealand to underpin its sector-specific reporting framework:

> *"entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders, that are not public sector public benefit entities (PBEs)".*

We also understand that the New Zealand NFP definition is similar to that used in the United Kingdom.

Australia has an even simpler NFP definition – *"an entity whose principle objective is not the generation of profit".* Although the AASB has considered enhancing this definition along the lines of the New Zealand definition, it decided that the cost of change would outweigh any benefits.

Both the Australian and the New Zealand experience suggests that focusing on the first two characteristics can still ensure that NFP entities with the other additional characteristics are captured. In our view, the third and fourth characteristics would be better referred to in supporting discussion as "indicators" that the NFP does meet the primary characteristics of delivering public benefit and directing any surplus towards delivering that public benefit.

We also have the following suggestions for more clearly articulating the first two characteristics:

1. Characteristic 1 should recognise the provision of "goods" as well as "services".
2. Characteristic 2 should recognise that "public benefit" includes not just the community at large/society as a whole, but also subsets of that community, such as member based

organisations. In this context, a discussion of the "principle of mutuality" would be beneficial to further clarify this characteristic of an NFP. Although the benefits provided by member based NFPs are provided to members in the first instance, that is generally considered sufficient to meet the "public benefit" test.

Finally, in considering the scope of NPOs as set out in Figure 1, we recommend that recognition be given to the fact that NFPs can sometimes be public companies and can also operate in the public sector.

General Matters for Comment 2

Chapter 2: Who are NPO stakeholders and what are their needs?

2a. Do you agree that NPOs are accountable to service users, resource providers, and regulators and have societal accountability? If not, why not? What alternative groups would you propose NPOs can be accountable to, and why?

Yes, we agree that NFPs are accountable to the broad groupings of users that are listed in the CP and that these terms are broad enough to include key users that are sometimes overlooked, including members of mutual organisations, employees and creditors.

However, we consider that it would be helpful if the discussion of societal accountability specifically identified the significant role that the granting of government tax concessions plays in providing an NFP with benefits for which they should be held accountable, not just by governments and their regulators but by their citizens as well.

However, recognition of such a broad group of users to which NFPs are accountable does mean that it is challenging to determine a reporting framework that can best meet the needs of a homogenous population of users. Therefore, we consider that in progressing this project, it will be necessary to identify the most common reporting needs of such a homogenous group of users. To assist in this regard, we draw your attention to the AASB Research Report 16: Financial Reporting by Non-Corporate or Small Entities which reviewed a substantial amount of academic literature in order to provide some assistance with the questions of user needs in the NFP sector.

2b. Do you agree that external stakeholders require information on an NPO's achievement of objectives, economy, efficiency and effectiveness, compliance with restrictions and regulations, and longer-term financial health, for accountability and decision-making purposes? If not, why not? What alternative areas would you propose and why?

Yes, we agree that external stakeholders have a wide-ranging set of information needs and that it is important that the NFP sector provides accountability to all of them. For this reason, both Australia and New Zealand have long required many of their NFPs, regardless of legal structure, to lodge information on the public record, in part, as an acknowledgement of the substantial tax concessions granted to them.

As an example, the Australian Charities and Not for Profits Commission (ACNC) maintains a Charities Register that contains details about a charity and its purposes, the names of the people involved in running the charity, as well as financial information and annual reporting. It also notes if the ACNC has taken any action against the charity for not complying with certain obligations. The ACNC also collates the data on the Charities Register in a variety of ways to assist users seeking aggregated sector information. It has recently published the 7th edition of its Australian Charities Report.

Similarly in New Zealand, Charities Services maintains a Charities Register for its 27,000 registered charities. The register helps the public, funders and other users to make better informed decisions about charities they may wish to support financially, volunteer for, or whose services they may wish to use with the aim of building and maintaining public trust and confidence in the charities sector.

It is clear that financial statements alone are unable to meet the diverse and growing information needs of users. This has resulted in growing recognition of the need to provide non-financial information to supplement the financial information placed on the public record. There has also been an increased focus on the content, comparability and consistency of the financial information to ensure financial statements are as effective as possible in communicating to NFPs stakeholders.

Since 1989 the New Zealand public sector has been required by law and regulation to report service performance information on the basis that non-financial information is important for accountability and decision making, as well as “telling the story” of the entity. More recently, the reporting of service performance information has been introduced for the NFP sector. More details on the New Zealand service performance reporting requirements are included in **Attachment 2**.

In Australia, although many public sector entities are required to report service performance information under applicable laws and regulations, there is no existing reporting standard for such reporting. The ACNC requires some non-financial information to be reported annually and has recently mandated the inclusion of certain information about charity programs.

While the development of mandatory service performance requirements is important, the AASB is currently focusing on development of a consistent and comparable reporting framework for NFPs as its first step toward effectively meeting user needs. More details on the Australian project is included in **Attachment 2**.

2c. Do you agree with the issues that have been identified with current accountability and decision-making arrangements for NPOs? If not, why not? Are there any other issues with current accountability and decision-making arrangements, particularly financial accountability to donors, that you would wish to highlight?

We agree that jurisdictional and funder reporting inconsistencies pose the greatest challenges to NFP reporting, potentially resulting in the scarce resources being utilised in an inefficient and unnecessary way.

The challenge of meeting jurisdictional specific reporting requirements is one that Australia has faced for many decades, with each state/territory operating its own legislative requirements for NFPs in addition to federal requirements. The reduction of red-tape and regulatory burden arising from this disparate and inconsistent regulatory system has been a key focus of the ACNC since its inception in 2012. While the ACNC has instituted significant reforms to address this challenge, work is still ongoing to further streamline regulatory reporting requirements.

In addition to jurisdictional challenges, funder reporting inconsistencies remain particularly common in the areas of grant acquittals and fundraising accountability laws. Again, disparate regulatory requirements have still not been effectively resolved via standardised reporting requirements and this remains a work in progress.

In New Zealand jurisdictional issues have been eliminated via a national reporting scheme, but similar challenges to Australia remain around grant acquittals and fundraising accountability.

General Matters for Comment 3

Chapter 3 What are the essential aspects of NPO financial reporting guidance?

3a. What, if any, do you see as the main challenges with Guidance that is accrual-based?

We support accrual accounting as the most appropriate basis for an NFP to discharge its financial reporting obligations to its stakeholders. It allows for an accurate representation of an NFP's income, expenditure, assets and liabilities. For this reason, the Australian and New Zealand NFP reporting frameworks generally adopt accrual accounting, but this does not negate the importance of understanding and communicating cash flow for NFPs. Therefore, a cash flow statement (consistent with IFRS 7 and IPSAS 2 Cash Flow Statements) is a mandatory primary financial statement within the reporting frameworks for NFPs of both countries.

There is also a recognition in both countries that the huge variety of sizes, staff resources and skills of NFPs means that many of the smallest NFPs do not have access to the level of financial skills that are necessary to implement an accruals-based accounting and reporting system. This has been formally recognised in New Zealand which allows its smallest Tier 4 charities to adopt a cash basis of reporting.

In addressing this issue further we refer you to section 4.3 of AASB Research Report 16 which summarises the available academic literature on the issue of accrual accounting in the NFP private sector. It concludes that while the literature broadly supports accrual accounting, the usefulness of this approach to users is fundamentally related to the nature and type of information being reported.

3b. What, if any, do you see as the main challenges with Guidance that includes non-financial information reporting?

We support reporting requirements that include an integrated NFP performance report containing both financial and non-financial information. This means an NFP can tell its whole story, demonstrating not only the financial results, but also non-financial metrics and narrative on how it has performed against its stated objectives.

Nevertheless, we are aware of a number of key challenges in the development of non-financial or service performance reporting requirements based on both the actual New Zealand implementation experiences and the development experience in Australia. They include:

- **Scope** – deciding what is reported (and critically what is left out) can be challenging and needs clear thinking from an external stakeholder perspective.
- **Verifiability** – service performance information needs to be capable of measurement or description in a consistent manner, be capable of independent verification and must exclude unsubstantiated claims. In particular, it can be difficult for entities to identify and articulate the level of responsibility they can claim for the achievement of outcomes.
- **Data capture** – systems may need to be improved, or even created, to enable information to be captured and reported.
- **Getting the right balance** – the information should include negative, as well as positive, service performance information.
- **Benefits v Costs** – clearly demonstrating that the benefits of this form of reporting outweigh the costs, particularly for small NFPs can be difficult. Experience gained from the implementation in New Zealand shows that many NFPs found it quite challenging to identify what service performance information to present and how best to present it.
- **Consistency** – identifying a single set of requirements for a wide range of NFPs, given the differences between entities in terms of what they are trying to achieve and the extent to which they can identify their influence on outcomes, is challenging.
- **Judgement** – there is a high level of judgement required around the selection, measurement, aggregation and presentation of service performance information.
- **Clarity** – requirements need to be expressed clearly and concisely in understandable language.

General Matters for Comment 4

Chapter 4 How far can existing international reporting frameworks assist NPOs

4a. Do you agree that international frameworks are the best start point for the Guidance? If not, why not?

Yes, both CA ANZ and CPA Australia have been strong long-term supporters of international harmonisation of accounting standards and have supported the use of international standards as the underlying base for much of the mandatory NFP reporting in both Australia and New Zealand. This has significantly reduced the development work required domestically in the time since these frameworks were adopted.

Nevertheless, there is widespread awareness in both countries that NFP reporting requirements need to be proportionate to the size of the entities and readily understandable by preparers, particularly given the sector's scarce resources. This was an important consideration in New Zealand developing its domestic Tier 3 and Tier 4 NFP simple format reporting standards.

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It has also underpinned the support by CA ANZ and CPA Australia for the IASB's continued development of its IFRS for SMEs standard and our calls for its incorporation into an effective differential reporting regime in Australia. While the IFRS for SMEs standard is not formally in use in either country, its concept of 'public accountability' and its disclosure reduction principles have subsequently been used to develop the reduced disclosure regimes that operate in both jurisdictions for Tier 2 entities producing general purpose financial reports. Its recognition and measurement simplifications are also being considered as input to the AASB's current work on developing a new Tier 3 NFP reporting standard (see April 2021 AASB Action Alert).

4b. Do you agree with the criteria that have been used to assess the suitability of the existing international frameworks? If not, why not and what other criteria do you believe could be used and why?

Yes, these criteria are consistent with those that were considered important when both Australia and New Zealand considered the international framework on which to base their NFP frameworks. We consider that the generally positive experiences of each country with implementing and modifying them has demonstrated their suitability as a base for the IFR4NPO project.

4c. Do you agree with the high-level assessment of the existing international frameworks against these criteria? If not, why not? What assessment would you make and why?

Yes, the assessment is consistent with underlying principles applied in both Australia and New Zealand for the adoption and modification of our NFP standards and is also consistent with the reasoning behind our support for a role for IFRS for SMEs in Australia's differential reporting regime.

General Matters for Comment 5

Chapter 5 Proposed Way forward.

5a. What do you see as the main challenges, if any, with the proposed Guidance model and the use of the IFRS for SMEs Standard as the foundational framework? What, if any, alternative model and/or foundational framework do you suggest would be more suitable and why?

We support using the IFRS for SMEs as the most appropriate international framework initially, given that it is a single standard, developed with users of a particular economic size in mind and seeks to provide clear and readily understandable requirements and guidance on the key issues that are relevant to SMEs. It is also sufficiently similar to IFRS and IPSAS that it does not pose significant transition issues for the existing skilled professionals familiar with those frameworks.

However, in adopting this framework we expect there to be key challenges in:

- **Identifying a suitable group of NFPs** to serve as a reference point for the development of the most common requirements. While the CP discusses its intended audience, with paragraph 3.4 suggesting there are widespread benefits, and paragraphs 5.3, 5.17, 5.18 and Figure 5.3 attempting to better define the scope, we do not consider that this provides a workable basis on which to progress the project. Without a clearer articulation of the type, size, and nature of the NFP that are within the primary scope, including illustrative examples, we do not consider that it will be possible to arrive at a clear understanding of the common NFP for which the guidance will be of use. This in turn will make it difficult to synthesise the user needs of such NFPs into a framework for the production of a general-purpose financial report that will meet those needs. We therefore recommend that more consideration be given to narrowing the scope of the project to identify a key target audience, which in turn will clarify user needs and requirements. A conceptual description similar to the "public accountability" concept contained in IFRS for SMEs could assist in this regard. We also refer to research commissioned by the New Zealand External Reporting Board into the common transactions of smaller, which is published as Typical transactions in charities.

- Dealing with **the consistency and comparability issues** that might come from NFPs needing to address issues not covered by the guidance (and where the guidance should direct its users for further assistance).

- Identifying and developing **consistent accounting policies for complex NFP issues** such as income/grant recognition, non-exchange transactions, donated/concessionary assets, conceptual framework challenges and fund restrictions for which there is limited international guidance and agreement.

Attachment 2

Background information regarding NFP reporting

Included below is additional background information and references from both Australia and New Zealand, which support our responses to the Questions in **Attachment 1**.

Australia

Standard setting pronouncements

The current list of standards applicable to NFPs required to prepare general purpose financial statements can be accessed on the AASB website. These standards are based on IFRS and apply to both the for-profit and NFP sectors under the AASB's "transaction neutrality" policy, which holds the view that "like transactions and events to be accounted for in a like manner by all types of entities". However, where user needs, prevalence and magnitude of issues specific to the NFP sector have been identified, and where NFP application issues and undue cost or effort considerations are important, the AASB modifies these standards to address these issues. This standard-setting approach is set out in the AASB's Not-for Profit Standard Setting Framework. Modifications are separately identified by Aus. paragraphs, separate Aus. appendices or by the development of domestic NFP-specific standards. The AASB staff prepared a paper that identifies the main modifications, which is particularly helpful for groups that contain both for-profit and NFP entities. It should be noted that for the purposes of such modifications, the AASB considers both public sector and private sector NFP's under the broad "NFP" umbrella.

Improving NFP accountability (Question 2(b))

As noted in our response to Question 2(b) Australia currently does not have mandatory service performance reporting requirements detailed in a standard. However ED 270 Reporting Service Performance Information was published in 2015, and more recently the AASB has produced AASB Research Report 14 Literature Review: Service Performance Reporting for not-for-profits. This provides a systematic review of both the Australian and international academic literatures regarding reporting of service performance information for private and public NFPs, including charities.

The AASB is now engaged in a broad review of Australia's NFP reporting requirements which is aiming to produce a simple, proportionate, consistent and transparent financial reporting framework for all private sector NFPs in Australia. As part of this work, the AASB decided at its February 2021 meeting to defer further consideration of service performance reporting reforms so as not to delay progress on the broader reform project. However, in making that decision the AASB reiterated that it "considers reporting of service performance information useful to users of the financial statements of NFP private sector entities."

New Zealand

Standard setting pronouncements

New Zealand has sector-specific standards for for-profit and public benefit entities (PBEs). It should be noted that the XRB considers both the public and the private NFP sectors under the broad PBE umbrella. The PBE reporting framework comprises a multi-tier approach (four tiers for PBEs) so that reporting requirements are proportionate to the size of the entity. The current list of standards applicable to NFPs that are required to produce general purpose financial reports can be accessed on the XRB website. The Tier 1 and Tier 2 standards are based on modified IPSAS The Tier 3 and Tier 4 standards are single simple format reporting (SFR) standards that have been developed domestically. Tier 3 is an accruals-based standard, while Tier 4 is a cash-based standard.

Definition of NFP (question 1(a))

In developing the NFP definition used in New Zealand (refer our response to Question 1(a)) the New Zealand Accounting Standards Board (NZASB) established a working group to consider how reporting entities should be defined in the NFP sector. This issue is particularly important because entities can take many different legal forms, including unincorporated bodies. Relevant information is found in the NFP Reporting Entity Concepts Working Group Report.

Improving NFP accountability (Question 2(b))

As noted in our response to Question 2(b) New Zealand has had service performance reporting requirements since 1989 in the public sector. Tier 3 (expenses under NZ$ 2 million) and Tier 4 charities have been required to prepare a Statement of Service Performance since 2016 (see Tier 3: Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit) (PBE SFP-A (NFP)) (Section 4) and Tier 4: Public Benefit Entity Simple Format Reporting – Cash (Not-for-profit) (PBE SFP-C (NFP)) (Section 4)). Tier 1 and Tier 2 charities will be required to apply a new standard PBE FRS 48 Service Performance Reporting from 2022.

CA ANZ produces a best practice NFP reporting guide for both Australia and New Zealand that encourages the preparation and publication of performance information (see Enhancing not-for-profit reporting Part A: Enhancing performance reporting).

Modifying the internationally based framework to meet the needs of NFPs (Question 4a)

In determining its approach to NFP standard setting, the NZASB concluded that user needs could not be adequately addressed by a single set of accounting standards applying to all NFP entities. This led to the development of a multi-tier framework with sector-specific standards. More details on this rationale is set out via these XRB webpages:

- Accounting standards framework: a multi standards approach
- Recent history of our accounting standards framework

The rationale for modifications to IPSAS is explained in the XRB's Policy approach to Developing PBE standards.