14 March 2024

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Dear Sam

International Non-Profit Accounting Guidance Exposure Draft Part 2

As the representatives of over 300,000 professional accountants around the world, CPA Australia and Chartered Accountants Australia and New Zealand (CA ANZ) thank you for the opportunity to comment on International Non-Profit Accounting Guidance (INPAG) Exposure Draft Part 2 (“the ED”). We make this submission on behalf of our members and in the public interest.

We are strong supporters of the Non-Profit Organisation (NPO) sector and many of our members are involved with the sector in Australia and New Zealand as advisors, auditors, employees and volunteers. In Australia and New Zealand, the term not-for-profit (NFP) is commonly used to refer to organisations that make up the sector. Since the ED refers to these organisations as NPOs, we have used the terms interchangeably throughout our submission based on the context.

Overall comments

We commend all those involved in the INPAG project for the direction and quality of the work that is going into the development of these proposals. We also commend the IFR4NPO for its aim of keeping the accounting requirements simple, which will be critical to overcoming the distinct implementation challenges many NPOs face, given their limited financial skills and volunteer staff, and encouraging widespread global adoption.

In particular, we support the use of the International Financial Reporting Standard for Small and Medium-Sized Enterprises (IFRS for SMEs) as the basis for INPAG. We also agree in principle with departing from IFRS for SMEs where necessary and using International Public Sector Accounting Standards (IPSAS) instead in the interests of ensuring that INPAG is fit-for-purpose for NPOs. The aim must be to produce accounting guidance that is easy to apply and meaningful to stakeholders.

We are therefore pleased to provide support for most of the proposed requirements in the ED. We believe they will enable NPOs to demonstrate transparency to their stakeholders on their strategic, financial and operational activities, stewardship of resources and overall accountability.

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This view is based on our member's experiences of implementing a comprehensive, mainly IFRS-based reporting framework in the NFP sectors in Australia and New Zealand. Our experience suggests that most of the proposals in the ED align with accounting requirements that are either in force in our jurisdictions, or are being implemented, to make them more fit for purpose for our smaller NFPs.

However, that implementation process has highlighted a significant lack of financial literacy that characterises the sector in our jurisdictions. This makes the effective application of quality accounting practices to produce financial statements that are meaningful to their users, challenging.

Revenue and expense recognition using "enforceability through legal or equivalent means"

We are concerned that the revenue and expense recognition and deferral proposals in the ED, while conceptually sound, are overly complicated and legalistic. We believe it will be difficult for many NPOs to classify and justify their agreements as either Enforceable Grant Arrangements (EGAs) or the Other Funding Arrangements (OFAs), resulting in a far wider use of the OFA requirements than may align with their stakeholder's expectations on reporting outcomes. This in turn could compromise the ability of the financial statements to effectively communicate the state of the NPO's activities and raise further funding.

We believe that these proposals need to be simplified to reflect the circumstances, skills and resources of the sector more effectively. The bar for identifying performance obligations needs to pragmatically recognise the substance of transactions and so should be able to be based on a clearly documented expectations over the use of grant as agreed between both parties, rather than on obligations that are "enforceable thorough legal or equivalent means". We acknowledge that this will involve judgement and require detailed guidance, but in our experience NFPs and their donors are able to identify and agree on specific performance obligations that are consistent with their desired objectives despite the legal documentation often being unclear or imprecise.

To this end we strongly support work being done with grantors and other donor groups to standardise reporting requirements and to improve quality of underlying documentation such as grant agreements. Clear examples of wording that can identify suitable performance obligations will not only support desired reporting outcomes, but also improve the consistency of reporting in the sector in the longer term to a point where a more conceptually pure approach is feasible.

We discuss this issue further in our responses to Questions 4 and 5 in the Attachment.

The need for comprehensive ongoing support

If IFR4NPO is to achieve its goals, it is insufficient to develop high-quality accounting guidance without planning for, and then devoting both time and resources to raising literacy to the level where quality financial statements, based on sound accounting principles, are understood and valued by their key users. In our experience, much of the NFP sector in our jurisdictions still struggle with this goal, constrained as they are by skills and resources. We expect this issue to be even more significant in countries where NPO reporting requirements are less well developed.

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Therefore, even the simplest new requirements could be challenging for the sector to implement unless they are accompanied by a comprehensive education and implementation programme that will support the resources that need to be available with the final standard. Our experience is that NFPs particularly value clear comprehensive guidance and illustrative examples that will support the adoption process and help mitigate against the risk that implementation advice is required from auditors. Particular areas where this will be important include the fair value and performance obligations requirements.

We also recommend that the consideration be given to planning for the timely conduct of a post-implementation review to understand user experience, identify implementation challenges and further shape the education programme going forward.

Detailed responses to questions posed in the ED.

As mentioned above, Australia and New Zealand currently have their own NFP reporting frameworks which make use of IFRS and IPSAS principles. In recent years both frameworks have undergone further reform to better balance the costs of preparing information with the needs of stakeholders. As a result, the knowledge and experience gained by our members when applying both the more complex requirements of our frameworks, and the various iterations of simplifications enable us to identify key areas where simplifications are essential, and the key technical challenges involved. We have therefore reviewed the INPAG proposals based on this experience and have set out our views on some of the specific topics and proposals in the ED in the **Attachment**.

If you have any questions about our submission, please contact either Tiffany Tan (CPA Australia) at tiffany.tan@cpaaustralia.com.au
or Zowie Pateman (CA ANZ) at zowie.pateman@charteredaccountantsanz.com.

Yours sincerely

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Attachment

Financial instruments (Question 1)

We support the proposed approach of accounting requirements for financial instruments based on distinguishing between basic and complex financial instruments as it is less complex and offers a cost-effective reporting solution for most NPOs. We also agree that there are no additional alignment amendments required to Section 11.

Inventories (Question 2)

We agree that there is a need for INPAG to provide guidance on donated inventory as this is a common occurrence for many NPO's. We also support introducing a permitted exception to not recognise as inventory certain donated low value items as this is a pragmatic approach which appropriately balances the cost/benefit. However, determining what is low value is judgmental and such a requirement could make financial statements less comparable. Therefore, this is an area where clear implementation guidance and illustrative examples will be important.

We also support the proposal to measure donated inventory at fair value. However again this is an area where judgement will be required and therefore these proposals will need to be supported by educational materials that address challenging areas for example; determining fair value when there is no active market (new or second-hand market), specialised items, loss of service potential etc.

We also support the proposed disclosure requirements which we agree will provide stakeholders with an appropriate level of information about inventories.

Fair value

As noted above, we support the use of fair value for inventory valuation and that it should be based on the requirements developed for inclusion in the IFRS for SMEs standard. We also note that the INPAG secretariat acknowledges that it will "consider whether further guidance or modifications to either section 12 or 13 are required" as part of the development of these requirements in INPAG Exposure Draft Part 3 (ED 3) (see Basis of Conclusions, paragraph 13.13).

In our joint submission to the IFRS for SMEs consultation on its development of Section 12 (Fair Value Measurement) we emphasised that there would be a need for that standard to be supported by SME specific guidance on matters such as highest and best use, exit value and market participant assumptions to ensure that the standard is consistently applied. We believe that these same topics will be specific issues for NPOs also and so again there will be a need for clear implementation guidance and illustrative examples when this section is developed for inclusion in ED 3. This work may reveal further instances where there is a need to develop more practical expedients, such as that proposed for "donated inventory" in order to ensure that the fair value requirements being imposed are in fact simple and easy for the sector to apply.

Provisions and contingencies (Question 3)

We agree with removing the illustrative example on warranties from the implementation guidance and replacing it with a new example on onerous contracts as this will increase the relevance of the requirements in an NPO context.

Revenue (Question 4)

Structure of section 23 (Question 4(b))

We believe that the proposed structure of section 23, distinguishing between revenue from contracts with customers and grants and donations is helpful and clear.

EGA versus OFA (Questions 4(a), 4(k), 5(a) and 5(b))

The proposed requirements for revenue are primarily dependent on distinguishing Enforceable Grant Arrangements (EGA) and Other Funding Arrangements (OFA). We acknowledge that the proposals do provide a sound conceptual basis for the treatment of grant revenue and expenses, implementing current requirements in IFRS and IPSAS in an NPO context.

However, we have concerns that the implementation of these requirements, as currently drafted, is likely to be challenging and costly. The concept of “enforceability via legal or equivalent means”, is a high bar to meet, potentially quite complex to determine and could vary significantly between jurisdictions.

The result is likely to be that most agreements will be treated as OFAs, even if both parties to the agreement can recognise specific future activities that could be used as performance obligations if the hurdle was lower.

This immediate recognition approach then presents NPOs with significant communication and relevance issues in the financial statements that are presented to their stakeholders when the funds received are in fact related to expenses that are yet to be incurred.

While some of these issues can be resolved by comprehensive disclosure about restricted funds, NFPs in both Australia and New Zealand would prefer that the accounting requirements more closely mirrored their obligations and stakeholder expectations (not withstanding that these may not be legally enforceable or meet the technical definition of a liability under the Conceptual Framework).

Recognising present obligations for revenue deferral (Question 4(c)) and 5(c))

We believe that there is a need to make the requirements more practical by lowering the enforceability bar to one where there are clearly documented expectations over the use of grants agreed between both parties. This will allow NPOs to reflect the substance of their arrangements in their reporting without needing to ensure the obligations they identify are sufficiently documented in their grant agreements to be “enforceable through legal or other equivalent means”.

As an example, the Australian Accounting Standards Board (AASB) is considering basing the revenue recognition requirements of its draft proposed Tier 3 standard on "a common understanding evidence by the transfer provider in writing or some other form that the entity is expected to use the inflows of resources in a particular way or act or perform in a particular way that results in outflows of resources". This change is in response to significant member feedback that Australia's current revenue recognition requirements, set out in Appendix F of AASB 15 Revenue from Contracts with Customers and AASB 1058 Income for Not for Profit Entities (AASB 1058), which require the identification of "sufficiently specific performance obligations", are expensive and difficult for the sector to apply, particularly the smaller end, and has not eliminated the diversity in practice that was occurring.

While we have concerns that the AASB's revised approach is still subjective and will therefore need to be supported by clear guidance and examples, we believe it is a more pragmatic solution to the reporting issues faced by NPOs than that currently proposed in the ED.

Similarly in New Zealand, in May 2023, the External Reporting Board revised the Reporting Requirements for Tier 3 Not-for-Profit Entities to allow revenue to be recognised over time as "documented expectations" are satisfied.

Therefore, we recommend the IFR4NPO consider a more pragmatic approach for grant revenue and obligation recognition requirements that more clearly includes the actual experience of the NPO/grantor relationship rather than just the legal terminology set out in its grant agreements. We appreciate the challenges associated with applying the Conceptual Framework definition of a liability to grant transactions and so recognise that "matching" without clear and specific obligations is not an appropriate option. However, our experience with the diversity of grants and activities using a "sufficiently specific performance obligation" approach makes it clear that a more practical, rather than a pure conceptual approach would better serve the sector at this time. It will still allow a transition to a better basis of revenue recognition that, longer term may allow a more technical approach to be implemented once the financial literacy of the sector is raised (see comments in our cover letter).

To this end, we commend IFR4NPO on the work being done with grantors and other donor groups to improve the quality of underlying documentation such as grant agreements to support outcomes they want to achieve. Clear agreed examples of examples of wording that would support desired reporting outcomes will be of significant benefit to NPOs, their auditors and other stakeholders in resolving revenue recognition issues. These can then be supplemented by education efforts to help both NPO's and their stakeholders understand the accounting, the reasons behind it and the improvement it represents to a cash-based approach.

Allocation methods (Question 4(d))

We support the proposals for allocation of revenue to performance obligations as being consistent with the requirements of IFRS for SMEs.

Low value items (Question 4(e))

We also support the exception introduced for low value items to defer the recognition of revenue when items are sold at sale amount as a practical solution to record keeping complexity.

Mission critical services in-kind (Question 4(f))

We support the recognition of revenue for mission critical services in-kind that where value of such services can be measured reliably. Our experience is that measuring services in kind is complex, but we agree that in mission critical areas the benefits of measuring these services are likely to outweigh the costs of doing so and Australia's AASB 1058 *Income for Not-for-Profit Entities* does permit optional recognition using fair value (see paragraph 18 onward).

Donations in-kind (Question 4(g))

We support the measurement of donations in-kind i.e., non-current assets and high value items, at fair value. We recommend including NPO specific illustrative examples (both basic and complex) as measurement of fair value is generally considered to be a challenging area for NPO preparers (see our comments on fair value above). In addition, we also recommend providing educational materials, including illustrative examples for other challenging areas such as principal versus agent.

Administrative tasks (Question 4(h))

We support IFR4NPO's view that the completion of administrative tasks are not enforceable obligations that could be used to justify revenue deferral. The purpose of these tasks is only to demonstrate that the NPO has met its obligations, and so they are incidental to the actual fulfilment of those obligations.

However, it is important to ensure that the INPAG guidance cannot be seen to imply that such tasks are not "necessary" and worthy of adequate funding. Our experience suggests that NFPs often struggle to gain sufficient funding to both perform the required obligations and perform the necessary support tasks to ensure that work is adequately managed and reported on. This is becoming an increasing issue as NFPs, like their corporate counterparts, are expected to address long term social and environmental sustainability issues such as diversity and inclusion, reducing emissions and eliminating modern slavery. It is therefore important that IFR4NPO uses its global platform to continue to acknowledge the importance of adequately funding administrative tasks for NFPs.

Disclosures (Question 4(i))

We also support the proposed disclosure requirements which we agree will provide stakeholders with an appropriate level of information about revenue.

Expenses on grants and donations (Question 5)

Consistent with our views on revenue recognition (see our response to Question 4) we consider that grantors will also face significant practical challenges classifying grant expenses as an EGA or as an OFA. In our experience the documentation surrounding grants and grant acquittals is often inadequate to enable the identification and satisfaction of detailed performance obligations to be clearly demonstrated.

In particular, we do not support the recognition of prepayments, considering that requiring grantors to base their expense recognition on reporting from grantees involves a level of complexity that, while conceptually sound, is practically fraught and likely to be difficult for stakeholders to understand and administer.

To this end, as noted in our response to Question 4, we support IFR4NPO's work with donor groups and grantors to develop clear examples of wording to support the recognition of performance obligations.

Finally, we support the proposed disclosures for grants, including the sensitive information exemption which is a practical solution to the risks that disclosures may pose to some NFPs.

Borrowing costs (Question 6)

We agree with applying the requirements from Chapter 25 in IFRS for SMEs that recognises all borrowing cost as an expense in the period in which they are incurred. This is an appropriate means of reducing complexity in this area.

Share-based payments (Question 7)

Our experience is that guidance on share-based payment is not required by NFPs in our jurisdictions.

Employee benefits (Question 8)

We support the proposal to remove profit sharing accounting requirements as our experience is that such type of employee benefit is not common in NFPs in our jurisdictions.

We also question whether the accounting for termination benefits and defined benefit plans could be removed as, in our experience, these are also not common in NFPs in our jurisdictions. We therefore recommend further investigation of the need for these requirements.

We recommend that in developing the employee entitlement requirements, clear examples are provided to assist NFPs with various matters associated with liability recognition, such as timing of relevant events, employee costs in addition to salaries (such as workers compensation or superannuation) and current/non-current classification as such topics have proved challenging in our jurisdictions.

Foreign currency translation (Question 10)

We agree that with the proposals concerning foreign currency transactions and are not aware of any other NFP specific issues that need to be dealt with.

Editorial amendments to income tax, hyperinflation and post balance date events (Questions 9, 11 and 12)

We support the inclusion in INPAG of the principles from IFRS for SMEs on:

- **Income tax**, although we note that accounting for taxes is not usually an issue for NFPs in our jurisdictions.
- **Hyperinflation** and consider that all necessary changes have been made to section 31 of IFRS for SMEs.
- **Events after the reporting period** and consider that all necessary changes have been made to section 32 of IFRS for SMEs.

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