

A Report on the Application to Not-for-profit Entities in the Private and Public Sectors

of

The IASB/FASB Conceptual Framework Project's

Exposure Draft of

**An improved Conceptual Framework
for Financial Reporting:**

**Chapter 1: The Objective of Financial Reporting
Chapter 2: Qualitative Characteristics and Constraints
of Decision-useful Financial Reporting Information**

and

Discussion Paper

**Preliminary Views on an improved
Conceptual Framework for Financial Reporting:**

The Reporting Entity

July 2008

Chairs and Senior Staff of:
Australian Accounting Standards Board
Canadian Accounting Standards Board
New Zealand Financial Reporting Standards Board
United Kingdom Accounting Standards Board

What this Report is About and Why it has been Prepared

This Report has been prepared by a group of chairs and senior staff members of standard-setting bodies in Australia, Canada, New Zealand and the United Kingdom. It comments on the applicability to not-for-profit entities in the private and public sectors of the concepts proposed in the first Exposure Draft in the IASB/FASB Conceptual Framework Project on The Objective of Financial Reporting and the Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information (“the *Exposure Draft*”) and the preliminary views expressed in the second Discussion Paper in that project, on The Reporting Entity (“the *Discussion Paper*”). The IASB/FASB Conceptual Framework Project is, for the time being, focusing exclusively on concepts for private sector businesses. The objective in publishing this Report is to highlight the key not-for-profit entity issues the group has identified:

- for the information of the IASB; and
- to inform the not-for-profit constituencies of the standard-setting bodies about issues that they may wish to consider.

This is the second Report prepared by the group to highlight some of the more significant issues in the application to not-for-profit private and public sector entities of the proposals and preliminary views published by the IASB and FASB. The group identified some of the more significant issues arising from the first Discussion Paper published by the IASB and FASB, on the Objective of Financial Reporting and the Qualitative Characteristics of Financial Reporting Information, in a Report in July 2006. This second Report repeats significant issues where they remain relevant.

Summary of the Report

- S 1 Not-for-profit entities have different objectives, different operating environments and other different characteristics to private sector businesses (profit-seeking entities). These differences are discussed in Appendix A to this Report, which acknowledges that there are also many similarities between not-for-profit entities and private sector businesses.
- S 2 Both the *Exposure Draft* and the *Discussion Paper* issued by the IASB and FASB cover private sector businesses only – this Report considers how some of the differences in the not-for-profit sector affect the possible application of the concepts

proposed by, and the preliminary views expressed by, the IASB and FASB to entities in that sector.

S 3 Section A of this Report considers the *Exposure Draft*. Part 1 of this Section considers the applicability of the proposed Objective of Financial Reporting to not-for-profit entities in the private sector. It raises three significant issues:

- the adequacy of the emphasis on accountability/stewardship;
- a need to broaden the identified users and establish an alternative primary user group; and
- the overemphasis on cash flows.

It also notes the implications for the objective of financial reporting in the not-for-profit sector of a possible broader scope of financial reporting.

S 4 Part 2 of Section A considers the applicability of the proposed Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information to not-for-profit entities in the private sector. It notes that:

- the qualitative characteristics and constraints proposed in the *Exposure Draft* appear generally to be appropriate for not-for-profit entities;
- some of the issues raised in Part 1 are also pertinent to the proposed qualitative characteristics and constraints;
- the qualitative characteristics and constraints may need to be reassessed for not-for-profit entities if a broader scope of financial reporting is agreed; and
- while the *Exposure Draft* does not discuss different cost-benefit assessments for different categories of private sector businesses, different cost-benefit assessments may be necessary when contrasting private sector businesses with not-for-profit entities because of the different objective of those entities, the different primary user group and the consequent different incidence of benefits and costs.

S 5 Section B of this Report considers the *Discussion Paper* on The Reporting Entity. It raises three significant issues:

- the need for a different description of a reporting entity as a consequence of not-for-profit entities having a broader primary user group;
- the need to address some specific issues that arise in determining what is a reporting entity in the not-for-profit sector; and
- the possible need for the concept of control to be further developed so that it can apply more effectively in a not-for-profit context.

S 6 Appendix B comments on issues raised in both Sections A and B as they relate to not-for-profit entities in the *public* sector.

Preface

Background

P1 On 29 May 2008 the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) published two documents in their joint project to develop a common and improved Conceptual Framework for Financial Reporting.

They are:

- the first Exposure Draft entitled:

“An improved Conceptual Framework for Financial Reporting:
Chapter 1: The Objective of Financial Reporting
Chapter 2: Qualitative Characteristics and Constraints of Decision-useful
Financial Reporting Information”
- the second Discussion Paper entitled:

“Preliminary Views on an improved Conceptual Framework for
Financial Reporting:
The Reporting Entity”

Comments have been requested on both documents by 29 September 2008.

P2 The *Exposure Draft* follows the publication in July 2006 of a Discussion Paper on the topics that are addressed in that *Exposure Draft*. The Boards received 179 responses to that Discussion Paper, have considered the comments received and now put forward the *Exposure Draft*.

This Report

P3 This Report comments on the applicability of the concepts proposed in the *Exposure Draft* and the preliminary views explained in the *Discussion Paper* to not-for-profit entities in the private sector and, in Appendix B, to public sector entities that do not have a profit objective. The Report results from the efforts of a “monitoring group” consisting of board chairs and senior staff members of standard-setting bodies in Australia, Canada, New Zealand and the United Kingdom.

P4 When the IASB and FASB commenced their joint Conceptual Framework project, they decided to focus initially on business entities in the private sector. Once

concepts for those entities have been developed, the Boards have indicated they will consider the applicability of those concepts to financial reporting by other entities, such as not-for-profit entities in the private sector and business entities in the public sector.¹

- P5 The writers of this Report were concerned about the implications of the IASB/FASB Conceptual Framework project for not-for-profit entities² and firstly encouraged the IASB and FASB to consider these entities continuously throughout their project and, at a later stage, proposed that the implications for not-for-profit entities be considered at the end of each phase of the IASB/FASB project. The IASB and FASB considered these views but reaffirmed their intention to consider the application to not-for-profit entities only once concepts had been developed for private sector businesses. They noted that, at this time, the Boards believe that not-for-profit sector specific issues are not of the same priority as the broad cross-cutting issues being addressed in the first four phases of the project. Several Board members expressed concern that giving the necessary attention to specific not-for-profit sector issues now would unduly delay consideration of those broad conceptual issues that are of utmost importance to those Boards' ongoing standard-setting efforts. Also, concerns were noted about the additional staff and advisory expertise that would need to be assembled to contemporaneously consider issues from a not-for-profit sector perspective.
- P6 Representatives of the four countries involved in writing this Report were encouraged by the IASB to monitor the project from the perspective of private and public sector not-for-profit entities and have been considering issues on a monthly basis since mid-2005. Issues identified are, where appropriate, drawn to the attention of the IASB and FASB. The International Public Sector Accounting Standards Board (IPSASB) is an observer of the monitoring group process and receives all reports.
- P7 The monitoring group considers it is important that the more significant issues it has identified are considered by individuals and organisations considering the *Exposure Draft* and *Discussion Paper* documents from the IASB and FASB, in particular the not-for-profit constituencies of the standard-setting bodies involved. Accordingly, it has prepared this Report and made it available publicly.

¹ Paragraph P9 of the *Preface to the Exposure Draft* and Paragraph P4 of the *Preface to the Discussion Paper*.

² Their concerns stem from the fact that the standard-setters involved have a responsibility to develop standards for not-for-profit entities and are committed to using the pronouncements of the IASB in their work.

- P8 The approach taken is to highlight implications of applying the concepts proposed and preliminary views expressed by the IASB and FASB to private sector not-for-profit entities (and, in Appendix B, public sector not-for-profit entities). Because the IASB/FASB project is at this stage developing concepts for private sector businesses only, our comments are not criticisms of the material as it applies to the entities for which it is intended³ but rather identify issues that would need to be considered if the material were also to be applied to not-for-profit entities in the private and public sectors.
- P9 The IASB and FASB have decided that each Board, within the context of its respective current hierarchy, will finalise the common framework as parts (chapters) are completed. Later phases of the project⁴ may include consequential amendments to parts of the framework that were completed earlier. It seems preferable to minimise the extent to which consequential amendments are necessary when not-for-profit considerations are taken into account. Also, considering these matters promptly may alleviate difficulty for those standards-setters that plan to adopt the IASB material into their own conceptual frameworks, which are applicable also to not-for-profit entities. This highlights the importance of the *Exposure Draft* and *Discussion Paper* being considered by the not-for-profit constituencies of the standard setting bodies involved.
- P10 Appendix A to this Report describes in general terms some of the characteristics of not-for-profit entities in the private sector and public sector.

³ This Report does not express any views in relation to the appropriateness of the concepts proposed or preliminary views expressed for private sector businesses.

⁴ Of which Phase G will consider the applicability of the concepts developed to not-for-profit entities.

Monitoring group members

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|----------------|--|
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| | Angus Thomson, Technical Director Australian Accounting Standards Board |
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Section A

Part 1 The Objective of Financial Reporting

1.1 The objective of financial reporting is, as stated in the *Exposure Draft*, the foundation of the framework. Other aspects of the framework flow logically from the objective and help ensure that financial reporting achieves its objective.⁵

1.2 Accordingly, it is essential that the objective of financial reporting is appropriate to the contexts in which it applies.

1.3 The objective of financial reporting proposed in the *Exposure Draft* is as follows:

*The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers. Information that is decision-useful to capital providers may also be useful to other users of financial reporting who are not capital providers.*⁶

1.4 There are three significant issues that have emerged from our review of the applicability of the proposed objective to not-for-profit entities or from the associated commentary in Chapter 1 of the *Exposure Draft*. These issues are:

- the adequacy of the emphasis on accountability/stewardship;
- a need to broaden the identified users and establish an alternative primary user group; and
- the overemphasis on cash flows.

We have also noted the implications for the objective of financial reporting in the not-for-profit sector of a possible broader scope of financial reporting. Each of these issues is considered below.

⁵ Paragraph OB1 of the *Exposure Draft*.

⁶ Paragraph OB2 of the *Exposure Draft*.

Adequacy of the emphasis on accountability/stewardship

- 1.5 The IASB and FASB have proposed a decision-usefulness objective, within the context of which they acknowledge the usefulness of financial reporting in assessing stewardship.⁷
- 1.6 The Basis for Conclusions acknowledges that different views continue to exist on whether providing information that is useful in assessing management's stewardship should be a stated objective of financial reporting either in addition to the objective of providing information that is useful in making resource allocation decisions or in place of that objective. The Boards have tentatively concluded that the objective of financial reporting should be broad enough to encompass all of the decisions that are made by capital providers based at least in part on their legitimate reliance on financial reporting information. Those decisions include resource allocation decisions as well as subsequent decisions made to protect and enhance their investment.⁸
- 1.7 In response to concerns raised on the first *Discussion Paper*, the Boards have thus given greater emphasis to the accountability or stewardship aspect of financial reporting, but within the context of a decision-usefulness objective.
- 1.8 In the case of not-for-profit entities, we consider that stewardship or the discharge of accountability may need more of an emphasis than the *Exposure Draft* has proposed. In the not-for-profit context, there are some circumstances where stewardship or the discharge of accountability is particularly important and does not fall within the decision-usefulness objective. For example, if major past donors to a charity lack the capacity to make decisions about reappointment of a charity's management and are unable to, or do not need to, make further donations, arguably the charity should still be accountable for the stewardship of the resources donated in the past. Accordingly, there should be consideration of whether stewardship or the discharge of accountability should be added as a separate objective.
- 1.9 The Conceptual Framework of each of the countries participating in the monitoring group includes accountability or stewardship explicitly within its objective of financial reporting. In some cases this is included as a separate additional objective and in other cases by inclusion within a single objective that is broader than decision-making.

⁷ See for example Paragraph OB12 of the *Exposure Draft*.

⁸ Paragraphs BC1.24 to BC1.29 of the *Exposure Draft*.

- 1.10 The recent UK Accounting Standards Board's *Statement of Principles for Financial Reporting: Interpretation for Public Benefit Entities* explains that some users will not have the same ability to make direct economic decisions as occurs for private sector businesses. They may however have the ability to vote at elections and this may indirectly influence the level of resources contributed to entities.⁹ A broader view of decision-making is thus taken in the UK Statement of Principles than appears to be the case in the *Exposure Draft*. However, that Statement also states that: "Accountability to a public benefit entity's stakeholders for the use of funds and the safekeeping of its resources is often of paramount importance and there may be a wide range of people having such an interest in the activities of the entity"¹⁰.
- 1.11 The Canadian Section 1000 *financial statement concepts* (applicable to for-profit entities and private sector not-for-profit entities) states that the objective of financial statements is to communicate information that is useful to investors, members, contributors, creditors and other users...in making their resource allocation decisions and/or assessing management stewardship.¹¹ It also states: "Information regarding discharge of the stewardship responsibilities is especially important in the not-for-profit sector where resources are often contributed for specific purposes and management is accountable for the appropriate utilization of such resources."¹²
- 1.12 New Zealand's *Framework for the Preparation and Presentation of Financial Statements* is the same as the existing IASB Framework except for a small number of modifications. It adds to the IASB's Objective, for **all entities** in New Zealand, as follows: "In addition to making economic decisions ... users of financial statements of New Zealand entities may also be interested in how well an entity has demonstrated its accountability in relation to a range of obligations including the entity's compliance with legislation, regulations, common law and contractual agreements."¹³
- 1.13 The Australian Framework is also the same as the existing IASB Framework except for a small number of modifications. It has not added to the IASB's Objective but has referred readers to a more detailed discussion in a separate Statement of Accounting Concepts¹⁴. That Statement specifies the objective as being to "provide information

⁹ Paragraph 1.4 of the *Statement of Principles for Financial Reporting: Interpretation for Public Benefit Entities*.

¹⁰ Paragraph 1.5 of the *Statement of Principles for Financial Reporting: Interpretation for Public Benefit Entities*.

¹¹ Paragraph 15 of Section 1000 *financial statement concepts*.

¹² Paragraph 14 of Section 1000 *financial statement concepts*.

¹³ Paragraph NZ 14.1 of the New Zealand Equivalent to the IASB Framework.

¹⁴ SAC 2 Objective of General Purpose Financial Reporting.

useful to users for making **and evaluating** decisions about the allocation of scarce resources”¹⁵. (emphasis added) It goes on to state a further concept, namely that: “Managements and governing bodies shall present general purpose financial reports in a manner which assists in discharging their accountability”.¹⁶

- 1.14 The International Public Sector Accounting Standards Board has stated the objectives of financial reporting should be to provide information useful for decision-making, and to demonstrate accountability of the entity for the resources entrusted to it.¹⁷
- 1.15 In the case of not-for-profit entities, resources are typically provided by sources unrelated to the recipients of goods and services delivered by the entities. Users want to know how resources were acquired and used, whether the ability to deliver goods and services has improved or deteriorated from the previous year and how well the goods and services were delivered. While some users will make resource allocation decisions with this information (such as to increase or decrease their support), some will not have the capacity or need to make such decisions but will still expect entities to be accountable for the resources provided¹⁸. We do not suggest that an accountability or stewardship objective should *replace* the decision-usefulness objective for not-for-profit entities, but that consideration is given to whether an additional objective should be established for not-for-profit entities. It may also be appropriate to consider whether a broader notion of decisions (such as to encompass, for example, voting and lobbying decisions) should be adopted.

A need to broaden the users and establish an alternative primary user group

- 1.16 The *Exposure Draft* identifies capital providers as having the most critical and immediate need for general purpose financial information about the economic resources of a (private sector business) entity. Capital providers include equity investors, lenders, and other creditors. The *Exposure Draft* acknowledges that information that is useful to capital providers may also be useful to other users of financial reporting who are not capital providers.¹⁹
- 1.17 Not-for-profit entities have both a different and a wider group of users. The users include those who provide resources to the organisation in the form of contributions.

¹⁵ Paragraph 43 of SAC 2.

¹⁶ Paragraph 44 of SAC 2.

¹⁷ IPSAS 1 Presentation of Financial Statements, paragraph 15.

¹⁸ See for example the circumstances described in paragraph 1.8.

¹⁹ Refer to Paragraph OB2 and OB8 of the *Exposure Draft*.

This category of user might be described as present and potential funders and financial supporters.²⁰ These users are interested in information about the utilisation of the resources provided to the entity that might be useful in making decisions about resources they may choose, or be required, to provide in the future. They are also interested in the stewardship of management of the resources under its control.

- 1.18 In considering the designation of a primary user group, it is important to note that the description of the primary user group in the *Exposure Draft* (capital providers) would generally only encompass creditors in the context of not-for-profit entities. We consider that the description of capital providers should be broadened to encompass funders and financial supporters and that recipients of goods and services and members of not-for-profit entities should also be considered primary user groups for not-for-profit entities.

The overemphasis on cash flows

- 1.19 The *Exposure Draft* states that “(a)n entity’s capital providers are directly interested in the amount, timing and uncertainty of cash flows from dividends, interest, and the sale, redemption, or maturity of securities or loans”²¹.
- 1.20 A concentration and focus on the ability to assess cash flow prospects is evident throughout the discussion of the Objective of Financial Reporting.
- 1.21 For not-for-profit entities, cash flows are also important. However, other aspects are generally more significant. These are matters related to the resources that are available to deliver future goods and services, the quality, cost and effectiveness of goods and services that have been delivered in the past, and how well the entity is meeting its objectives.

A possible future issue - the scope of financial reporting

- 1.22 The objective of financial reporting as stated in the *Exposure Draft* pertains to all of financial reporting, not just financial statements.²² The monitoring group welcomes this and notes its importance for application to not-for-profit entities.

²⁰ Refer to Paragraph 1.2(b) of the UK *Statement of Principles for Financial Reporting: Interpretation for Public Benefit Entities*.

²¹ Refer to paragraph OB10 of the *Exposure Draft*.

²² See discussion in paragraphs BC1.3 to BC1.5 of Chapter 1 of the *Exposure Draft*.

- 1.23 Specifically, the group notes that, in the context of not-for-profit entities, information about service performance is also important and the issue of what information is necessary to achieve the objective of financial reporting for these entities should be included in consideration of the scope or boundaries of financial reporting.
- 1.24 The Basis for Conclusions in the *Exposure Draft* also indicates that the issues of whether financial reporting should include prospective information or forecasts and, if so, how that information should be provided, will be considered as part the scope/boundary phase.²³ We note that budgets and the comparison of actual amounts with budgeted amounts are particularly important in the not-for-profit sector. This is because the operations of many not-for-profit entities are funded significantly by regular contributions provided on the basis of a formal published budget.
- 1.25 Accordingly, the monitoring group has identified a possibility that the objective of financial reporting for private sector businesses may need to be reassessed once the scope or boundaries are determined to ensure it responds to the needs of users in the not-for-profit sector.

²³ Paragraph BC1.5 of the *Exposure Draft*.

Part 2 Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information

2.1. The *Exposure Draft* has proposed two fundamental qualitative characteristics of decision-useful information:

- relevance; and
- faithful representation²⁴.

2.2. It has also proposed four enhancing qualitative characteristics, namely:

- comparability;
- verifiability;
- timeliness; and
- understandability²⁵.

2.3. The qualities are subject to two pervasive constraints that limit the information provided by financial reporting, namely:

- materiality; and
- cost²⁶.

2.4. Subject to the comments which follow, the qualitative characteristics proposed in the *Exposure Draft* appear generally to be appropriate for not-for-profit entities. However, each characteristic and constraint needs to be interpreted in the context of the objective of financial reporting and, accordingly, our observations in relation to the application of the objective need also to be borne in mind here. For example, for information to be relevant, it will need to be relevant to the identified users of financial reports of not-for-profit entities.

²⁴ Paragraph QC2 of the *Exposure Draft*.

²⁵ Paragraph QC15 of the *Exposure Draft*.

²⁶ Paragraph QC27 of the *Exposure Draft*.

- 2.5. Some of the specific concerns raised in relation to the objective of financial reporting arise also in considering the commentary supporting the qualitative characteristics. For example, paragraph QC3 states, in part, “Information is relevant if it is capable of making a difference in the decisions made by users in their capacity as capital providers.” While this statement may be appropriately expressed for private sector businesses, relevant information may, in our view, need to be described differently in the context of a broader objective of financial reporting for not-for-profit entities. Similarly, we note that what is material in the context of the constraints on the qualitative characteristics may need to be described differently for not-for-profit entities. For example, paragraph NZ 30.1 of the NZ Framework explains that information may be material where it could influence the decision-making and evaluations of users about the allocation of resources **and stewardship of resources, and the performance of the entity**, made on the basis of the financial statements. (emphasis added)
- 2.6. Apart from the flow-on effect of the issues we have raised in relation to the Objective of Financial Reporting, there are two other issues that we wish to highlight:
- the ability to assess the qualitative characteristics when the scope or boundary of financial reporting has not been determined; and
 - the pervasive constraint of “costs”.

Implications of decision to be made about the scope or boundary of financial reporting

- 2.7. As we have noted in our comments on the Objective²⁷, the Boards have deferred consideration of the scope or boundary of financial reporting. However, if a broader scope of financial reporting were found to be appropriate, that in turn may necessitate reconsideration of whether the qualitative characteristics are appropriate to all the types of information that may be included within the scope of financial reporting.

The pervasive constraint of “costs”

- 2.8. The discussion of the pervasive constraint of costs, at paragraphs QC29 to QC31 of the *Exposure Draft*, does not discuss the possibility of different cost-benefit judgements being made for different types of entities. We note however that

²⁷ See paragraphs 1.22 to 1.25 of this Report.

paragraph BC1.32 in the Basis for Conclusions for Chapter 1 of the *Exposure Draft* suggests that cost constraints sometimes may lead standard-setters to permit or require differences in reporting for some types of entities. We agree with that statement and the later comment in that paragraph that standard-setters have concluded that such differences are a result of variations in the perceived costs and benefits of the information when applied to different entity types. Different cost-benefit assessments may also arise when considering not-for-profit entities and may arise because of the different objective of these entities, the broader and sometimes different users and because the incidence of the benefits and costs may differ.

Section B

Part 3 The Reporting Entity

- 3.1 The IASB and FASB have formed the preliminary view that the conceptual framework should broadly describe (rather than precisely define) a reporting entity as “a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers”²⁸. Furthermore, a reporting entity should not be limited to business activities that are structured as legal entities²⁹.
- 3.2 We note that there are also entities in the not-for-profit sector that are not legal entities and, therefore, that not limiting a reporting entity to legal entities is equally important in this sector. Examples are branches, clubs and unincorporated societies.
- 3.3 The Boards have also formed the preliminary views that:
- If control is used to determine the composition of a group reporting entity, then control should be defined at the conceptual level;
 - Control over another entity entails both power over that entity and the ability to obtain benefits; and
 - Determining whether one entity has control over another involves an assessment of all the existing facts and circumstances³⁰.
- 3.4 Finally the Boards have formed the preliminary view that the composition of a group reporting entity should be based on control, and the controlling entity model should be used as the primary basis for determining the composition of a group reporting entity. In addition, there may be some circumstances in which the common control model³¹ may provide useful information to equity investors, lenders and other capital providers. The working definition of control the Boards have developed is as follows:
- “Control of an entity is the ability to direct the financing and operating policies of an entity, so as to access benefits from that entity (or to reduce the incidence of losses)

²⁸ Paragraph S2 of the *Discussion Paper*.

²⁹ Paragraph S2 of the *Discussion Paper*.

³⁰ Paragraph S4 of the *Discussion Paper*.

³¹ A model in which the results and activities of two or more commonly controlled entities are combined without inclusion of the controlling party (paragraph 80 and following of the *Discussion Paper*).

and increase, maintain or protect the amount of those benefits (or reduce the amount of those losses).”³²

- 3.5 There are three significant issues for not-for-profit entities that have emerged from our review of these preliminary views and from the associated discussion in the *Discussion Paper*. These issues are:
- the need for a different description of a reporting entity as a consequence of not-for-profit entities having a broader primary user group;
 - the need to address some specific issues that arise in determining what is a reporting entity in the not-for-profit sector; and
 - the possible need for the concept of control to be further developed so that it can apply more effectively in a not-for-profit context.

Each of these issues is considered below.

Need for a Different Description of a Reporting Entity

- 3.6 In our comments on the Boards’ proposed objective of financial reporting, we have commented that the focus on capital providers as users of financial reports is too narrow a focus in the not-for-profit sector (see paragraphs 1.16 – 1.18). We have suggested that funders and financial supporters should also be identified as capital providers and that recipients of goods and services and members of not-for-profit entities should also be considered primary user groups for not-for-profit entities.
- 3.7 The identification of a broader primary user group for the not-for-profit sector may need to be reflected in the description of the reporting entity and in consideration of other concepts related thereto. We note that if the description of the reporting entity were amended to reflect these factors, it would not necessarily mean that the boundary of the reporting entity would differ from that contemplated by the IASB and FASB.
- 3.8 In addition to these comments on the description of a reporting entity, it may also be appropriate to consider whether the term “business activity” used in the *Discussion Paper* is the most appropriate term to use in a not-for-profit context.

³² Paragraph 49 of the *Discussion Paper*.

Specific reporting entity issues arising in the not-for-profit sector

3.9 During the course of our monitoring work we have identified some reporting entity issues that may arise in the not-for-profit sector which the *Discussion Paper* does not address. These issues may necessitate additional consideration for the not-for-profit sector and possibly the development of additional concepts to guide standards-level decisions.

3.10 The issues include:

- Whether and in which circumstances branches or other sub-entities of a not-for-profit entity constitute reporting entities. An example may be when fundraising occurs at a branch level and where user decisions are made and the discharge of accountability is appropriate at that sub-entity level; and
- Whether and in which circumstances in this sector the common control model may have application.

Possible need for the concept of control to be further developed

3.11 We endorse the concept of control as the basis for determining the group reporting entity and agree that control should be defined at the concepts level.

3.12 However, we note that in the context of not-for-profit entities, the application of control (as defined to date by standard-setting bodies) has sometimes been difficult and the proposed definition should be assessed against the range of circumstances that arise in this sector to determine whether the definition is appropriate and whether additional commentary could be developed to assist in standards-level decisions.

3.13 For example, we think that the notion of benefits in the context of a definition of control may need to be explained to encompass achieving the objectives of the controlling entity rather than only accessing benefits flowing from that other controlled entity. Consideration could also be given to circumstances in which the objectives of two or more entities coincide, and the implications that may have for determining whether a control relationship exists.

3.14 Further consideration may also be necessary of issues that arise as a consequence of the frequent absence of defined ownership interests that can be sold, transferred

or redeemed or that convey an entitlement to a share of a residual distribution of resources, including on liquidation of the entity³³.

³³ See paragraph A 1.3 of Appendix A.

Appendix A The Nature of Not-for-profit Entities in the Private and Public Sectors

A 1.1 In this Appendix we set out some of the characteristics of not-for-profit entities in the private and public sectors. At this stage, we do not attempt to define not-for-profit entities.

A 1.2 From our experience in monitoring the IASB/FASB Conceptual Framework Project thus far, the issues that emerge in relation to applying the concepts to all not-for-profit entities can generally be related back to the characteristics of these entities. For that reason we think it is important to explain what some of their general characteristics are.

Private sector

A 1.3 Not-for-profit entities in the private sector generally have the following characteristics:

- their primary objective is to provide goods, services and/or funding to various recipients and not to make a profit;
- they are generally characterised by the absence of defined ownership interests that can be sold, transferred or redeemed or that convey an entitlement to a share of a residual distribution of resources, including on liquidation of the entity;
- the providers of resources are often different from the recipients of goods, services and/or funding provided by the entity;
- their receipts of resources generally are contributions rather than sales. Contributions may be solicited in the form of donations or assessed, such as through membership dues; and
- their capital assets are typically acquired and held to deliver services without the intention of earning a financial return on them.

A 1.4 There are many similarities between business (for-profit) and not-for-profit entities in the private sector. Specifically, the basic accounting systems and the accounting for most transactions is the same. However, financial reporting is concerned with the needs of users of financial information and the different primary objective of not-for-

profit entities does have a significant influence on the needs of the users of their financial reports. Some of these issues emerge in Section A of this Report.

Public sector

A 1.5 Not-for-profit entities in the public sector have very similar key characteristics to not-for-profit entities in the private sector.

A 1.6 These entities are typically established by or pursuant to legislation and:

- their primary objective is to provide goods, services and/or funding to various recipients or to develop or implement policy on behalf of governments and not to make a profit;
- they are almost always characterised by the absence of defined ownership interests that can be sold, transferred or redeemed;
- they often have a wide group of stakeholders to consider (including the public at large);
- their receipts of resources are generally derived from taxes or other similar contributions obtained through the exercise of coercive powers;
- the providers of resources are often different from the recipients of goods, services and/or funding provided by the entity; and
- their capital assets are typically acquired and held to deliver services without the intention of earning a financial return on them.

Appendix B Application to Not-for-profit Public Sector Entities

- B 1.1 In this Appendix we highlight some particular issues that emerge from the *Exposure Draft and Discussion Paper* in relation to *public* sector entities that do not have a primary for-profit objective.
- B 1.2 In 2006 the IPSASB commenced its own conceptual framework project. The monitoring group of standard-setters has been involved in that project in different ways including undertaking research on particular topics and providing comment on draft documents. We understand that a consultation paper covering the objectives of financial reporting, the qualitative characteristics of financial reporting, the scope of financial reporting and the reporting entity will be published by the IPSASB during the exposure period of the IASB/FASB *Exposure Draft and Discussion Paper* discussed in this Report. The IPSASB consultation paper is likely to be of interest to the readers of this Report.
- B 1.3 Each of the significant issues raised in Sections A and B of this Report is also an issue in the context of public sector not-for-profit entities. Accordingly, this Appendix highlights those aspects that are particularly significant for these entities or where the slightly different characteristics of public sector entities raise additional aspects deserving comment.

Section A

- B 1.4 Accountability or stewardship is an important *objective of financial reporting* for public sector not-for-profit entities such as governments or their sub-entities. For example, the Canadian Section PS 1100 *financial statement objectives* includes as one of its objectives: "Financial statements should demonstrate the accountability of a government for the resources, obligations and financial affairs for which it is responsible by providing information useful in: (a) evaluating the financial results of the government's management of its resources, obligations and financial affairs in the accounting period; and (b) assessing whether resources were administered by the government in accordance with the limits established by the appropriate legislative authorities."³⁴
- B 1.5 Public sector not-for-profit entities also have additional and sometimes different *users*. They include funders and financial supporters, including the public through the payment of taxes, and recipients of goods and services. They also have

³⁴ Paragraph .61 of Section PS 1100.

governing or oversight bodies that might be described as legislatures or elected/appointed representatives. These representatives are likely to use information to assess the entity's achievements against objectives, including how efficiently and effectively goods and services have been provided.

B 1.6 In the case of public sector not-for-profit entities, funders and financial supporters should also be identified as capital providers and recipients of goods and services and legislatures should also be considered primary user groups.

B 1.7 In relation to *the scope of financial reporting*, budgets have major significance for public sector not-for-profit entities. Furthermore, because the primary objective of these entities is not the making of a profit, information about service performance may be necessary to meet the needs of users.

Section B

B 1.8 In the case of public sector not-for-profit entities, any change to the primary user groups as suggested in paragraph B 1.6 above has possible implications for the description of a reporting entity.

B 1.9 A number of specific reporting entity issues have arisen in the public sector over recent years, and it would be appropriate in our view to consider whether concepts relating to the reporting entity would assist in resolving these issues at a standards-level. These issues include:

- When entities at a sub-entity level constitute reporting entities (noting that financial reporting is currently required of many sub-entities of governments in most countries);
- Whether a core government entity, such as the general government sector, which is circumscribed by certain government functions, is a reporting entity and the manner in which entities controlled by it should be treated for accounting purposes;
- The relationship of government regulation to control where a government establishes an entity through legislation, using the legislation as an “autopilot” mechanism; and
- Whether ministers (or their equivalents) and the activities under their responsibility constitute a reporting entity.

B 1.10 Application of the concept of control in the public sector raises some specific issues that warrant consideration as part of the development of the concept for this sector. As with not-for-profit entities in the private sector, there is a need to consider whether the notion of benefits needs broadening and what the consequences are of the frequent absence of defined ownership interests that can be sold, transferred or redeemed in the sector. An additional issue is the case of statutorily autonomous and independent entities in the public sector, some of which may comprise what have become known in the private sector business context as special purpose entities operating on “autopilot”. In the case of these entities, a government may not have the “ability to direct the financing and operating policies” of the (statutorily autonomous or independent) entity, yet these entities have normally been viewed by governments and standard-setting bodies as part of government reporting entities. Further consideration of this issue seems necessary in the development of reporting entity concepts for the public sector.