

Paper 5 Applying the AASB/FRSB Process for Modifying IFRSs for PBE/NFP to Service Performance Reporting by Private Sector Not-for-profit Entities

Background and introduction

- 1 At their October 2009 joint meeting, the AASB and New Zealand FRSB noted their respective project work on service performance reporting, including the range of entities that would be potentially affected because of:
 - (a) the AASB's focus on private sector not-for-profit (NFP) entities; and
 - (b) the FRSB's focus on public benefit entities (PBEs), which include public sector entities.

“The Boards discussed the potential benefits and challenges of working jointly, particularly in light of the different scopes.... The Boards observed that if the focus of the work were on developing general principles, the different scopes should not be an impediment to a joint project. The Boards noted that such an approach would not preclude the AASB from addressing issues which do not fall within the scope of the FRSB project.” (Draft minute item 9 of the 28-29 October 2009 AASB/FRSB meeting)
- 2 At its September 2009 meeting, the AASB considered the range of entities that might be affected by its work on service performance reporting and decided to “formally consider the project in the light of its *Process for Modifying IFRSs for PBE/NFP*, before determining whether the project should have implications for for-profit entities. In the meantime, the focus will continue to be on not-for-profit entities”. (Minute item 7, 4th (a) of the 23-24 September 2009 AASB meeting)
- 3 Although the Board's September 2009 decision refers to the project as a whole, this paper focuses only on the service performance reporting aspect of the project. Separate papers applying the *Process* to later phases of the project will be prepared for consideration by the Board at the appropriate time before those phases are commenced. Furthermore, although the *Process* does not focus on a distinction between private sector and public sector NFP entities, this paper only addresses the issues from a private sector NFP entity perspective. This is consistent with the Board's decision at its October 2009 meeting to, at least at this stage, not address public sector issues.
- 4 The *Process* has been developed by the AASB and FRSB jointly and is posted on the websites of both Boards. This paper applies the latest version of the *Process* (as at October 2009) with a view to determining whether there is a justification for imposing service performance reporting requirements on NFP entities, and only on NFP entities, in the absence of corresponding requirements in IFRSs. Accordingly, this paper particularly addresses paragraph 8 of the *Process*, which raises the question of whether to “...create requirements (including standards) applicable only to PBE/NFP, even though there is no corresponding IFRS.” The structure of this paper follows the structure of the *Process*.

A caveat

- 5 In some respects, this paper runs the risk of pre-empting the outcome of research that will be undertaken as part of the project (e.g. whether service performance reporting should be mandated or whether it should be included in general purpose financial statements). To mitigate this risk, the analysis of the issues identified in the *Process* are considered in terms of justifying work on the project proceeding with the narrow scope of private sector NFP entities rather than justifying what the outcome of that work ought to be. Therefore, staff views expressed in this paper are tentative and subject to the outcome of the ongoing project work and the Board's due process. Because the main purpose of this paper is to consider modified IFRS requirements for NFP entities relative to for-profit entities, rather than draw absolute conclusions in relation to NFP entities, we do not believe the approach we have taken undermines the tentative staff views expressed in this paper.

Factors to be considered before modifying an IFRS

- 6 Paragraph 9 of the *Process* states that: "Two questions would generally be considered before modifying an IFRS for PBE/NFP:
- (a) Are there issues that might warrant modifying an IFRS for PBE/NFP?
 - (b) Are the identified issues sufficiently significant to warrant a departure from an IFRS?"

The following considers each question in turn in relation to service performance reporting.

(a) *Are there issues that might warrant modifying an IFRS for PBE/NFP?*

- 7 Paragraph 12 of the *Process* notes that, to ensure user needs are met while considering the balance between costs and benefits, a modification to IFRSs (such as a non-IFRS standard) may be required for NFP entities following an assessment of the following factors:
- nature of transactions, events and circumstances and their impact on PBE/NFP;
 - benefits to users of complying with the IFRS; and
 - costs of complying with the IFRS.

Nature of transactions, events and circumstances and their impact on PBE/NFP

- 8 Paragraph 15 of the *Process* states that: "few transactions, events and circumstances would uniquely occur in relation to PBE/NFP. However, some transactions, events and circumstances are more common among PBE/NFP than for-profit entities and may warrant a separate standard or more specific guidance."
- 9 Although there are some 'transactions' and 'events' that are more common among NFP entities than for-profit entities (e.g. non-exchange transactions and non-cash generating assets or units), these 'transactions' and 'events' have little relevance to determining whether service performance reporting might be warranted for NFP entities, particularly if the financial consequences of such 'transactions' and 'events' are accounted for appropriately. In contrast, the 'circumstances' of a NFP entity differ from the circumstances of a for-profit entity. For example, in contrast to the

financial objective of profit of for-profit entities, a NFP entity has a principal objective other than profit that is typically non-financial in nature. Conventional financial statements are not an effective way to convey information about such an objective, and therefore a mechanism for presenting information about non-financial performance might be warranted for NFP entities.

Benefits of compliance to users

10 Paragraph 16 of the *Process* appears to emphatically acknowledge that, in contrast to for-profit entities, service performance reporting would provide benefits to users of NFP entities' financial statements. It states:

‘There are cases where user needs for information will differ between for-profit entities and PBE/NFP. In particular, users of the financial reports of a PBE/NFP entity are likely to be especially interested in:

- (a) service delivery, being the quality of the goods and services produced and whether this level of quality is appropriate;
- (b) efficiency and productivity, being more likely to involve information that is based on costs and on information about outputs/outcomes that may be non-financial in nature; and
- (c) sustainability, because the sustainability of a PBE/NFP is more likely to depend on it meeting its mission than on its profits and profitability, whereas the sustainability of a for-profit entity is primarily dependent on financial performance.’

11 The references to ‘service delivery’, ‘quality of goods and services’, ‘outputs’, ‘outcomes’, ‘non-financial’, ‘meeting its mission’ resonate strongly with notions of service performance reporting, suggesting there might be a strong case for issuing a non-IFRS standard on service performance reporting for NFP entities.

Costs of compliance

12 This factor is not relevant in the context of service performance reporting being contemplated in this project as its focus is on costs of compliance with IFRSs. There are no existing IFRS requirements relating to service performance reporting against which to assess this factor. Paragraph 18 of this paper considers the issue from the perspective of the costs of compliance with a non-IFRS standard.

Staff tentative views on question (a)

13 Yes, prima-facie, there are issues that might warrant a project with an objective of developing a non-IFRS standard specifically for NFP entities on service performance reporting that would not be applicable to for-profit entities. As noted above, the issues include:

- the nature of the principal objective of NFP entities, which is typically non-financial; and
- the information needs of users in relation to the principal objective.

(b) *Are the identified issues sufficiently significant to warrant a modification to an IFRS for PBE/NFP?*

14 To help decide whether the above issues warrant a PBE/NFP specific standard, the *Process* takes into account:

- (a) an estimate of the significance of any modification on the financial statements;

- (b) an estimate of the significance of a transaction, event or circumstance on the financial statements taken as a whole;
- (c) whether or not a modification will increase or decrease internal consistency within IFRSs as modified for PBE/NFP; and
- (d) the costs of preparing the modification and the costs of requiring preparers, auditors and users to learn and apply two sets of requirements.

An estimate of the significance of any modification on the financial statements

- 15 Information in service performance reports would be expressed to be significantly different from the information in conventional financial statements prepared in accordance with IFRSs. Therefore, it is expected that requirements for service performance reporting would have a significant impact on financial statements by providing improved financial and non-financial information for users of information about NFP entities.

An estimate of the significance of a transaction, event or circumstance on the financial statements taken as a whole

- 16 The typically non-financial principal objectives of NFP entities are a significant circumstance that distinguishes a NFP entity from a for-profit entity. Conventional financial statements focus on financial information. Therefore, when taken as a whole in contrast to for-profit entities, conventional financial statements do not provide sufficient information for users of NFP entities.

Whether or not a modification will increase or decrease internal consistency within IFRSs as modified for PBE/NFP

- 17 This factor is not relevant in the context of service performance reporting as its focus is on internal consistency within IFRSs, which do not address service performance reporting. However, arguably a modification for service performance reporting would increase consistency with the *Framework for the Preparation and Presentation of Financial Statements* as modified for NFP entities. For example:

“In respect of not-for-profit entities, ownership groups and contributors of donations are generally not concerned with obtaining a financial return but are usually more interested in the ability of an entity to achieve its **non-financial objectives**, which in turn may depend upon the entity’s financial position and financial performance.” (Paragraph Aus 15.1 of *Framework for the Preparation and Presentation of Financial Statements* Emphasis added)

“Aspects of the performance of a reporting entity can be measured in financial and **non-financial terms**. ... In relation to non-business entities, the information is useful in assessing the resources necessary to enable the entity to continue to provide **services** in the future and the likely cost of those services.” (Paragraph 29 of *SAC 2 Objective of General Purpose Financial Reporting* Emphasis added)

“**Non-financial measures of performance** may also be relevant to users for the purposes identified, particularly in relation to non-business entities. The absence of a profit or rate of return objective for these entities means that financial measures of performance are unlikely to be sufficient to assess fully the extent to which those entities have achieved their objectives, which typically include social as well as financial dimensions. The extent to which **non-financial performance measures** can be considered to fall within the scope of general purpose financial reporting will be the subject of a separate Statement of Accounting Concepts.” (Paragraph 30 of *SAC 2* Emphasis added)

The costs of modification

- 18 There would be additional costs incurred in preparing a service performance reporting modification and costs of requiring preparers, auditors and users to learn and apply the modification. staff note that the AASB is being provided with separate funding to undertake the project. Because the project would give rise to a new requirement that adds to existing GAAP, there would not be two sets of service performance reporting requirements for people to become familiar with. Given the nature of NFP entities and the information that might be included in service performance reports, it is reasonable to expect that, subject to due process, benefits from the additional information would outweigh the costs of specifying and complying with the requirements.

Staff tentative views on question (b)

- 19 Yes, prima-facie, the issues identified under question (a) are sufficiently significant to warrant a project that should consider whether to modify IFRSs for private sector NFP entities alone. The issues include the significantly improved non-financial (and potentially financial) information for users that could result.

Determining a different treatment for PBE/NFP

- 20 If it is accepted that service performance reporting is warranted as a modification to IFRS for NFP entities, the *Process* identifies the sources the Board should consider in determining what the modification should be. It identifies:
- (a) the AASB *Conceptual Framework*. As noted in paragraph 17 of this paper, the *Conceptual Framework* states that ownership groups and contributors of donations of NFP entities are ‘usually more interested in the ability of an entity to achieve its non-financial objectives’. However, the *Conceptual Framework* does not provide any detail about what that information is or the best way to convey the information.
 - (b) any modification to IFRSs or a public sector specific standard issued by the IPSASB. IPSASB has a project on *Reporting of Service Performance Information* that is awaiting comments on the IPSASB’s proposals relating to *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* before being commenced. The IPSASB’s *Conceptual Framework* project is addressing high-level issues relevant to service performance reporting, such as the scope of financial reporting. Therefore, the IPSASB’s project on *Reporting of Service Performance Information* is unlikely to assist us at this stage.
 - (c) the IPSASB *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. As it is not finished yet, the IPSASB’s *Conceptual Framework* is of limited use to us at this stage. Although, consideration could be given to the IPSASB’s proposals and ongoing deliberations as part of the AASB’s project, it is not expected to provide us with details about possible service performance reporting requirements.

- (d) the FRSB and whether or not the FRSB has modified, or is considering modifying, IFRSs in relation to the issue. As noted in agenda paper 9.1 of the October 2009 AASB/FRSB joint meeting, New Zealand has modified IFRS in the form of Technical Practice Aid TPA-9 *Service Performance Reporting*, and NZ paragraphs in NZ IAS *Presentation of Financial Statements* relating to service performance reporting. However, these documents are being reviewed by FRSB — and indeed AASB has agreed to work jointly with the FRSB to the extent the projects overlap and therefore reference to New Zealand material will inform the AASB’s work but will not provide an ‘off-the-shelf’ answer.
- (e) pronouncements issued by another national standard setter using a similar conceptual framework. Staff are aware of the Statement of Recommended Practice SORP-2 *Public Performance Reporting* issued by the Canadian Institute of Chartered Accountants, and the Concepts Statement No. 5 *Service Efforts and Accomplishments Reporting* (SEA) issued by Governmental Accounting Standards Board (GASB) of United States and on 30 June 2009, GASB also released a Request for Response on *Proposed Suggested Guidelines for Voluntary Reporting, SEA Performance Information*.
Staff research to date has included consideration of these pronouncements and developments and will include consideration of whether they would suit the Australian context. However, given the way in which practice has evolved in the absence of a pronouncement in Australia, staff think practice should also be considered in developing service performance reporting requirements.
- (f) the Government Finance Statistics Manual. It doesn’t address service performance reporting and therefore is not a relevant reference for us in this case.

Staff tentative views on determining a different treatment for PBE/NFP

- 21 One of the project’s objectives is to identify service performance reporting requirements for private sector NFP entities. Therefore, it would be premature to identify those requirements here. However, as noted above, in developing requirements for service performance reporting by private sector NFP entities, regard will be had to the *Conceptual Framework*, New Zealand work, international standard setters’ work and Australian practice.