



Technical Advisory Group

Issue Paper

AGENDA ITEM: TAGFG05-05

21 January 2024 – Online

Liabilities and equity – final draft

Summary	<p>This paper provides TAG members with:</p> <ul style="list-style-type: none">• a summary of the responses to the specific matters to comment (SMCs) for issues relating to Section 22 <i>Liabilities and equity claims</i> and Section 2 <i>Concepts and pervasive principles</i>• the Secretariat's views on those issues, and• suggested approaches for the final guidance.
Purpose/Objective of the paper	<p>The purpose of this paper is to provide a detailed analysis of the responses to Section 22. It seeks the views of TAG members on suggested approaches to the final guidance based on respondents' views and feedback on specific proposals.</p>
Other supporting items	<p>TAGFG05-05 Annex</p>
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Actions for this meeting	<p>Comment on:</p> <ul style="list-style-type: none">• the description of net assets as an aggregation and an element• other suggestions for the term net assets• the use of the term equity claims and whether an alternative should be used• whether there needs to be consideration of a pragmatic exemption for equity claims which might be difficult to measure.



Technical Advisory Group

Liabilities and equity – Response to ED3 and final draft

1. Introduction

- 1.1 This paper provides:
- a summary of the responses to the specific matters to comment (SMCs) for issues relating to Section 22 *Liabilities and equity claims* and Section 2 *Concepts and pervasive principles*
 - the Secretariat's views on those issues; and
 - suggested approaches for the final guidance, the draft final guidance – amendments are included in TAGFG05-05 Annex.

2. Background

- 2.1 TAG members will be aware that ED1 included equity as a financial statement element. Stakeholders raised concerns that the proposed definition of equity was problematic for NPOs. ED3 revised the definition of equity, removing it as a financial statement element, and replaced it with net assets. ED3 also provided clarification about the characteristics of equity instruments for NPOs.
- 2.2 Net assets are defined as the residual available to the NPO to achieve its objectives after deducting all its liabilities from its assets. In the rare instances where NPOs have some form of share capital or similar instrument, INPAG refers to these as equity claims. Equity claims are defined as the financial interest in the net assets of an NPO that is due to holders of those claims.
- 2.3 Section 22 is an updated section in INPAG but has not been fully reviewed by the Secretariat. It establishes the principles for classifying financial instruments as either liabilities or equity claims. It has been amended to reflect that INPAG does not use the term equity, with consequential amendments that reflect the expected nature of NPO equity claims.
- 2.4 A survey was carried out that considered some of the reporting issues that relate to Section 22. The results from the survey have been incorporated into the analysis of responses where relevant.
- 2.5 An Annex to this report includes the final guidance for Section 22 and relevant extracts of Section 2 relating to net assets and equity claims (note these paragraphs were reviewed by TAG at its September 2024 meeting). As reported in September 2024, Section 2 Application Guidance on net assets and equity claims

has been included within the core text. Some of these paragraphs will be subject to amendment following the final issue of *IFRS for SMEs* Accounting Standard.

3. Description of Net Assets

- 3.1 For SMC5(a) ninety-four percent of respondents agreed with the revised description of net assets and its inclusion as an element. Six percent disagreed. Fifteen respondents did not answer this SMC.
- 3.2 Respondents that agreed with the SMC commented that:
- it accurately describes net assets as the residual interest in assets after liabilities are deducted, which aligns with general accounting principles;
 - it provides a more accurate reflection of the resources available for achieving the organisation's objectives and emphasises the fiduciary responsibility that NPOs must manage assets used for their mission-driven purposes;
 - equity is a very for-profit term whereas net assets is more neutral.
- 3.3 Two respondents that disagreed (both from the same jurisdiction), commented that the details of net assets must include the initial asset receivables, assets sourced from the management and development of initial assets, and the net proceeds from asset management and development. The Secretariat is not clear why this is being suggested and does not consider that such information is relevant to the proposed new definition of net assets.
- 3.4 Two respondents commented that that both parts of the statement of financial position included the same label net assets.
- 3.5 One of these respondents also commented that net assets implied debit balances to describe resources which are represented by credits in the bottom half of the balance sheet. This respondent also suggested that a better name for the element would be to describe it as “funds, reserves and equity claims”. Their view was as equity claims and revaluation reserves are likely to be rare this could be reduced to “Funds”.
- 3.6 The Secretariat acknowledges that as net assets is both an aggregation line (and in the top half of the balance sheet) and an element it might lead to confusion. However, there was substantial support from respondents to the proposal.
- 3.7 The Secretariat can understand the respondent’s suggestion for a different description (funds, reserves and equity claims) but considers that the term “net

assets” appears to be a succinct and more useful description for the residual element representing the resources available to fund future activities.

3.8 Some respondents provided detailed responses including drafting comments.

They focussed on:

- alignment with other financial reporting standards
- the definition of equity claims and non-controlling interest
- whether equity claims are liabilities
- the descriptions of balance sheet headings and items.

The Secretariat’s responses are included in Appendix B.

Question 1: Do TAG members agree with both the description and the definition of net assets as an element in the financial statements?

Question 2: Do TAG members agree with the Secretariat’s responses in Appendix B?

4. Equity claims as a subset of net assets

- 4.1 For SMC5(b) eighty-seven percent of respondents agreed with the use of the term equity claims in Sections 2 and 22 and that equity claims are a subset of net assets. Two percent disagreed and eleven percent neither agreed nor disagreed. Seventeen respondents did not answer this SMC.
- 4.2 Seventy-two percent of 127 respondents to the survey considered that it was either very important or somewhat important that INPAG provides for the reporting of equity claims.
- 4.3 Respondents that agreed commented that equity claims as a subset of net assets reflects the reality that NPOs do not typically have shareholders but may issue instruments with equity-like characteristics. They commented that they confer rights to future economic benefits or service potential and can include entitlements to distributions in the event of liquidation. They also commented that the inclusion of equity claims as part of net assets aligns with the concept that equity claims reflect specific entitlements within the broader net assets available to the NPO.
- 4.4 A respondent that agreed commented that in their jurisdiction NPOs are legally required to be established as companies limited by guarantee. Such a setup does not include shareholders but, instead, members who commit to meeting resource claims for the amounts guaranteed in case of winding up. The respondent considered that shares in an NPO do not appear to provide an entitlement to

anything else other than a return of one's contributed funds in the form of a guarantee.

- 4.5 A further respondent suggested that equity such as shares are a subset of NPOs' [net assets] but where these rights exist disclosing them is important to transparency and it may be a local jurisdiction's legal requirement. The Secretariat concurs.
- 4.6 The respondent that disagreed was of the view that the term "equity" should not be used in the context of non-profit organizations. Instead, it should be referred as a "net asset claim." Another respondent commented that references to equity claims should go in a "special Section" as it relates to very rare circumstances and "does not belong in Section 2"
- 4.7 The Secretariat is still of the view that any typical commercial forms of equity claims will be rare for NPOs following INPAG and the responses to this SMC would support this. However, it cannot exclude the possibility that such transactions exist.
- 4.8 The description of equity claims also covers transactions (which appear to be occurring more regularly in NPOs) where resources are contributed to establish the NPO and may need to be returned if an NPO is wound up or passed on to successor organisations. The Secretariat is of the view that equity claims should not be in a separate section but relevant commentary about the frequency of transactions should be included (as is the case in paragraph G2.80).
- 4.9 A respondent who neither agreed nor disagreed was of the view that the term equity claims may not appropriately represent the balance as it reflected some form of ownership by the 'holder' and, it also implies that the holder continues to have exposure over these funds, such as, for example, rights to liquidate/sell these assets, or rights/obligations to realised/unrealised gains and losses related to them.
- 4.10 This respondent suggested that instead the term should be 'Founding capital and capital contributions' or simply, 'Founding capital' to reflect the substance of the transaction. This is based on their experience and assumption that capital contributions are typically the legally required minimum capital provided.
- 4.11 The same respondent was of the view that the use of the term 'holder' for the contributor implies that they continue to have free exposure over those funds,

which may rarely be the case. They considered the use of 'contributor' may better reflect the transaction.

- 4.12 The Secretariat considers that there may be arguments for a different term, at least for transactions described by the respondent. Some of these transactions might be better described as a contribution. This has support in standards as, for example, ownership contributions is the term used in the IPSASB Conceptual Framework for an element representing an inflow of resources contributed by owners which establish an interest in the entity.
- 4.13 It is difficult, however, to develop a term which covers the different types of transactions which might meet the description of equity claims for NPOs (this typically would be transactions where there is a claim on the resources of the NPO which do not meet the definition of a liability). The Secretariat does not propose to explore an alternative description given that there has been limited evidence provided by the survey and the consultation responses and therefore considers a wider description is the safest option.
- 4.14 A respondent suggested adding additional guidance to differentiate equity claims from liabilities (amounts held in trust, endowment funds, etc.). Another respondent commented that the definitions and application of equity claims should be consistently applied across all related sections to avoid confusion. Any unusual circumstances where equity claims exist should be clearly outlined to ensure transparency
- 4.15 The Secretariat considers that both equity claims and liabilities are separately identified in Section 2 and that there is sufficient guidance to deal with this (though further guidance may be developed over time when there is further evidence on transactions which meet the description of equity claims).
- 4.16 The Secretariat would note that most of the examples in Section 22 which illustrate transactions are commercial transactions from the *IFRS for SMEs* Accounting Standard. For example, puttable instruments meet the definition of liabilities but are classified as equity claims. An example of a type of financial instruments classified as liabilities rather than equity claims has been added to reflect NPO circumstances (at paragraph G22.6 (b)).
- 4.17 Section 22 has been subject to amendment ie the transactions related to the sale of options, rights and warrants, extinguishing financial liabilities with equity instruments and treasury shares have been removed but some guidance on

convertible debt or similar compound financial instruments and capitalisation or bonus issues and share splits has been retained as it is possible that an NPO has control of, acquires or merges with another entity that has share capital.

- 4.18 The amendments made reflect the fact that Section 22 has not been fully reviewed and has instead been updated. The Secretariat would suggest, however, that the Basis for Conclusions emphasises that Section 22 has not been subject to a full review and has introduced a new paragraph BC22.1.
- 4.19 The Secretariat would also not suggest that at this stage that there are any changes to the description of equity claims (as the full range of possible transactions that might occur). The Secretariat is also of the view that it would be worthwhile including Section 22 for a full review in future editions of INPAG when there is a fuller understanding of the transactions that might or might not meet the definition of equity claims.
- 4.20 A respondent was of the view that it would be clearer if AG2.7 preceded AG2.6 [now paragraphs G2.80 and G2.81]. They were of the view that a statement is also needed that a claim by a third party would only arise if the NPO is dissolved. The respondent considered that if equity claims are substantial this would call into question whether the entity was an NPO.
- 4.21 The Secretariat is of the view that paragraphs G2.80 and G2.81 appear to be in a logical order with paragraph G2.80 describing the general context for equity claims and paragraph G2.81 providing examples of the different types of equity claims. The Secretariat considers that equity claims might arise on dissolution of an NPO, but it is not clear from current information that these would be the only circumstances. The Secretariat also considers that decisions about whether an entity should apply INPAG are covered by the broad characteristics tests in Section 1 NPO.
- 4.22 Comments also included that NPOs may have certain financial instruments that resemble equity in form but are not equity in the traditional sense (e.g., membership shares that don't entitle holders to a claim over net assets). The Secretariat considers that this is addressed by the Sections 2 and 22 and particularly paragraph G22.7.

Question 3: Do TAG members consider that alternative descriptions for equity claims should be considered such as founders' contributions?



Question 4: What are TAG members' views on the approach to the guidance on equity claims in Section 22?

5. Section 22 – financial instruments held by NPOs

- 5.1 As discussed in Section 4 of this report paragraphs relating to the sale of options, rights and warrants, extinguishing financial liabilities with equity claim instruments and treasury shares have been removed from Section 22 and the paragraphs relating to capitalisation or bonus issues of shares and share splits and convertible debt, or similar compound financial instruments have been retained. Per SMC5(c) ninety-five percent of respondents agreed with this proposal. No respondents disagreed and five percent neither agreed nor disagreed. Twenty respondents did not answer this SMC.
- 5.2 Respondents providing comments indicated that the transactions that were removed were rare transactions and should be removed indicating that this would simplify reporting. They commented that including these concepts in NPO financial reporting would misrepresent how NPOs operate and could cause confusion for stakeholders.
- 5.3 One respondent commented with regard to extinguishing financial liabilities with equity claim instruments that NPOs do not usually engage in complex financial structuring involving such transactions. They were also of the view that treasury shares are not applicable because NPOs' structures and funding do not typically involve repurchasing their own shares.
- 5.4 A respondent discussing the retained paragraphs indicated that the guidance can be beneficial if an NPO has any equity-like structures or needs to manage such events.
- 5.5 A respondent commented that shares that give a voting right but no significant financial benefit "need a mention", but if the NPO has the power to issue stock dividends, they were of the view that such entities are not NPOs as generally understood. The Secretariat concurs that issuing dividends might indicate that the NPO is not an NPO but considers that this will be covered by the broad characteristics guidance in Section 1.
- 5.6 One respondent was of the view that INPAG should include commentary that in some cases commercial accounting may be more appropriate (e.g. the full *IFRS for SMEs* Accounting Standard) rather than INPAG. The Secretariat considers that

guidance from Section 22 is already included for transactions likely to be applicable to NPOs which will cover transactions that might be more like commercial transactions. Reference to *IFRS for SMEs* Accounting Standard or other international standards should be covered by the commentary in the Preface.

- 5.7 A respondent commented that they were not sure how relevant the sections on the capitalisation of bonus issues of shares and share splits, convertible debts, or compound instruments are to NPOs, unless there are for-profit entities owned by the NPO. The Secretariat agrees that these transactions are unlikely to be regularly occurring transactions. The Basis for Conclusions argues that such transactions might occur where an NPO merges with an organisation which has share issues. The Secretariat considers that this could still be the case.
- 5.8 A respondent that agreed also commented that the bigger issue is to identify the character of the equity claim first by differentiating between equity funding advanced by supporters where it is redeemable only on winding up of the NPO and equity claims issued to either settle a transaction or equity that has a redemption date and so represents a form of financing. For the latter adopting the for-profit effective interest method makes sense but the [two] former [transactions] are best left undiscounted at face (par) value.
- 5.9 The Secretariat agrees that measuring equity claims that are advanced to supporters is more difficult and that the undiscounted value might be a close approximation to fair value at their inception. However, the Secretariat is of the view that such transactions should be measured in accordance with Section 22 (at fair value) and at least the passage of time might mean that at par measurement is no longer appropriate. The Secretariat considers that the valuation techniques in Section 12 *Fair value measurement* should be able to accommodate most instruments. The Secretariat does not propose to introduce a pragmatic exemption for equity claims where it would be difficult to measure the fair value, pending a full review of both Section 2 and 22.

6. Amendments made

- 6.1 The amendments made to Sections 2 and 22 (including the Basis for Conclusions for Section 22) are summarised in the table below. These are all minor changes. The updated drafts of these Sections are available in TAGFG05 – Annex.

Paragraph	Amendment made
<i>Section 2 Concepts and pervasive principles</i>	
G2.91	Explanatory cross reference to paragraph G2.93 (providing an explanation of the last sentence of paragraph G2.91).
G2.141	Minor correction – replacement of “entity” with “NPO”.
<i>Section 22 Liabilities and equity claims</i>	
G22.8	Edits included in latest draft of <i>IFRS for SMEs</i> Accounting Standard
<i>Section 22 Basis for Conclusions</i>	
New paragraph BC22.1	Introductory paragraph indicating that Section 22 has not been subject to review.
BC22.2	Link to new paragraph BC22.1 to reflect the rationale for the amendments to Section 22.
BC22.3	Minor wording change for clarity.
BC22.5	Replace “this section” with “Section 22”.
Across Basis for Conclusions	Update for new paragraph numbers.



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Appendix A

Summary of Feedback Responses on Expenses SMCs

SMC 5(a) Do you agree with the revised description of net assets and its inclusion as an element? If not, what would you change and why?	Response	Number	% of those who responded
	Agree	45	94%
	Disagree	3	6%
	Neither agree nor disagree	-	-
	No Response	15	-
		63	100%

SMC5(b) Do you agree with the use of the term equity claims in Sections 2 and 22 and that equity claims are a subset of net assets? If not, what would you change and why?	Response	Number	% of those who responded
	Agree	40	87%
	Disagree	1	2%
	Neither agree nor disagree	5	11%
	No Response	17	-
		63	100%



SMC 2(c) Do you agree that the paragraphs relating to the sale of options, rights and warrants, extinguishing financial liabilities with equity claim instruments and treasury shares are removed from Section 22 and that the paragraphs relating to capitalisation or bonus issues of shares and share splits and convertible debt or similar compound financial instruments are retained? If not, why not?

Response	Number	% of those who responded
Agree	41	95%
Disagree	-	-
Neither agree nor disagree	2	5%
No Response	20	-
	63	100%

Detailed comments on the description of net assets

Comment	Secretariat Response
<ol style="list-style-type: none"> 1. Net assets should be defined/added to the glossary 2. Section 2, the last sentence of G2.81 (However, not all items that meet the definition if one of those elements are recognised) could [cross] refer to G2.83 or have the words 'due to inherent uncertainties' added to the statement to assist understanding of when this may appropriately occur. 3. Section 2, G2.141 reduce verbiage which can confuse by choosing either 'it may be necessary' OR 'where relevant'. 4. Section 2, G2.147 add the word 'individual' before 'assets, liabilities, net assets...' 	<p>The Secretariat:</p> <ol style="list-style-type: none"> 1. concurs 2. considers that a cross reference to paragraph G2.83 (G2.93 in the current draft) is useful. 3. considers that such changes (to paragraph G2.151) will need to await the final version of the <i>IFRS for SMEs</i> Accounting Standard as this paragraph is based on the standard. 4. considers that such changes (to paragraph G2.153) will need to await the final version of the <i>IFRS for SMEs</i> Accounting Standard as this paragraph is based on the standard.
<p>Clarification on Non-Controlling Interests: The reference to non-controlling interests being included in net assets is useful but might need further elaboration in cases where it applies</p>	<p>The definition of net assets includes references to relevant distributions (see paragraph G2.81) which may include non-controlling interests. The Secretariat considers that further elaboration may confuse stakeholders about the importance of such components of net assets.</p>
<p>Ensure that the description and treatment of net assets align with broader financial reporting standards and practices.</p>	<p>The Secretariat considers that the definition of net assets aligns with the definition in international standards though there may be an issue with the description being both an aggregation in the top half of the balance sheet and an element.</p>
<p>The previous version where equity claims would be regarded as part of net assets (G2.73) was rather misleading, as any claims should have been catered for under the liabilities to the NPO.</p>	<p>The Secretariat considers that these are still a part of net assets and that they are claims against an entity that do not meet the definition of a liability.</p>



Comment	Secretariat Response
In the illustrative balance sheet 'Net assets', and revaluation reserve comes under the heading 'funds' even though it is not a fund.	Agreed the Secretariat will make the relevant changes.
The technical name of the financial statement element is of less consequence to users than the labels and heading on the financial statements themselves. We recommend that the heading for this section of the balance sheet be 'Source of net assets', with sub-headings for 'funds', 'reserves' and 'equity claims' as needed	The Secretariat assumes that this is referring to the descriptions of aggregations of the balance sheet line items and the Secretariat will consider this when reviewing Section 4 Statement of financial position but agrees that where material the components of net assets should be adequately described.