

IFRNPO Guidance

January 2021

Response Document

PART 1: GENERAL NPO FINANCIAL REPORTING ISSUES

Instructions for completion

IFR4NPO has published this document for respondents to use for submitting their comments.

This document presents all of the questions in **Part 1** of the Consultation Paper with spaces for responses.

Respondents are encouraged to complete this document electronically but are not required to use this document. They may also respond using their own comment letter format or the online survey available at: <https://www.ifr4npo.org/cp-survey/>

Comments on **Part 1** are requested by **30 July 2021**

Information requested from all respondents

Name¹:

Samantha Musoke

Email address:

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Description of your role if responding as an individual:

Project Director IFR4NPO, Humentum. UK Chartered Accountant resident in Uganda for 20 years, specialist in non-profit financial management issues as consultant, trainer, CFO, auditor and board member.

Description of the activities of the organisation where responding on behalf of an organisation:

Humentum, an NPO that supports other NPOs to be effective and efficient, especially in areas such as finance, HR etc

Jurisdiction(s) to which the feedback relates:

Uganda

Accounting basis of NPO financial reports in the jurisdiction in which you mainly work:

(iii) Modified cash

Many report on accrual basis, many on cash basis and a majority on a modified basis, expensing assets.

Financial reporting standard use by NPOs in the jurisdiction in which you mainly work

(i) IFRS

But many don't apply it fully. IFRS for SME is not commonly referred to in audit opinions. Sometimes auditors cite the framework as undefined 'GAAP' and sign off based on their own understanding or interpretation.

¹ Name of person providing the response and whether this is in an individual capacity or on behalf of an organisation.

Please indicate whether you wish to receive further information about this project and consent to being contacted at the email address provided.

☒ *Agree*

☐ *Disagree*

This document has been designed purely to enable feedback to the IFR4NPO consultation. The responses will be used to shape the development of the IFR4NPO Guidance and not for any other purpose. We ask for your name and contact information to enable us to contact you if we should have any clarifications regarding your responses. Responses to the consultation will be public, but personal contact information will not be disclosed. Participation in this consultation is undertaken on an entirely voluntary basis. Personal information will only be held for the purposes of the project. You may withdraw your consent for us to hold any of your personal information at any time by contacting us at IFR4NPO@cipfa.org

Information requested only if the organisation on behalf of which you are responding is an NPO

Which International Classification of Non Profit Organisation (ICNPO) group best describes your organisation and activities?²

Dropdown menu. Please select description that is closest.

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Rank revenue sources of your NPO in order of importance (optional)

	1	2	3	4	5	6
(i) Grants	☐	☐	☐	☐	☐	☐
(ii) Donations	☐	☐	☐	☐	☐	☐
(iii) Sale of goods and services	☒	☐	☐	☐	☐	☐
(iv) Gifts in kind	☒	☐	☒	☐	☐	☐
(v) Services in kind	☐	☐	☐	☒	☐	☐
(vi) Other	☐	☐	☐	☐	☐	☐

Please provide any further information on revenue source including description of Other in this box.

Approximate total revenue per annum of your NPO in US\$ (optional)

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² http://ccss.jhu.edu/wp-content/uploads/downloads/2011/09/CNP_WP19_1996.pdf

General Matters for Comment (GMC)

Introduction

Part 1 of the Consultation Paper discusses the broader NPO landscape and considers this in the context of the project objectives set out in the Introduction. Part 1 includes a description of the broad characteristics of NPOs. It considers accountability and decision making and the role that general purpose financial reports can play in providing decision useful information for external stakeholders. Finally, it looks at the suitability of existing international and national financial reporting regimes as the basis of future NPO Guidance.

Comments are welcome on any or all of the parts in the Consultation Paper. Please note:

- There is no requirement to respond to all issues
- You may respond to all of the questions raised in the Consultation Paper or may choose to respond only about certain elements
- There is no minimum number of questions that can be addressed in a response. But, the greater the number of responses received, the richer the feedback for the project team to consider.

Contents

Chapter 1 *What are non-profit organisations?* outlines a broad characteristics approach to describing NPOs for developing the Guidance

Chapter 2 *Who are NPO stakeholders and what are their needs?* examines NPO external stakeholders, what information those external stakeholders need for accountability and decision-making purposes, and issues with current arrangements

Chapter 3 *What are the essential aspects of NPO Financial Reporting Guidance?* explains two key premises to develop the Guidance to support the provision of information that is useful for accountability and decision-making

Chapter 4 *How far can existing international financial reporting regimes assist NPOs?* highlights that limitations on time and resource mean that the Guidance must draw on existing frameworks. International financial reporting frameworks are proposed as the basis of the Guidance, with each having its advantages and disadvantages

Chapter 5 *Proposed way forward* puts forward a proposed model for developing the Guidance. The proposal uses *IFRS for SMEs* as a foundational framework and draws on full IFRS, IPSAS and jurisdiction level standards to develop the Guidance

Each Chapter provides General Matters for Comment (GMCs)

Chapter 1 *What are non-profit organisations?* outlines a broad characteristics approach to describing NPOs for developing the Guidance.

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

The four characteristics are presented as 'OR', implying that an entity need only identify with any one of them for the Guidance to be potentially applicable or useful.

I propose that the application of any surpluses to a public/community/social benefit objective should be an essential requirement, with the existence of a benefit objective, receipt of voluntary income and the holding of social purpose assets as additional characteristics.

There are many for-profit enterprises that generate a return to investors, by means of carrying out a business that could be described as public benefit – agriculture, medicine, energy etc. Many for-profit entities frame their purpose in terms of achieving something good for society. Their financial reporting needs can be met by existing standards, especially in light of new sustainability reporting.

There are certain types of membership organisations, trusts, clubs, societies, cooperatives or associations that exist primarily to benefit (financially and/or otherwise) their members and may be considered 'not-for-profit' according to these characteristics. If those members comprise a 'small' number of 'privileged' individuals, this would seem to be against the spirit of the phrase public/community/social benefit. None the less, non-profit accounting principles may apply if surpluses are not distributed to members, even if privileges such as tax exemption were denied.

Chapter 2 *Who are NPO stakeholders and what are their needs?* examines NPO external stakeholders, what information those external stakeholders need for accountability and decision-making purposes, and issues with current arrangements.

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

I propose that governors such as board members, trustees or directors be included as an additional significant group of users. On one level and in some contexts they are 'internal', analogous to company directors that control the entity to the extent that they can require production of any financial information they need. But for NPOs that do not have members, as trustees, their role is also analogous to 'external' shareholders.

In this sense, and frequently in practice in Uganda, they are among the most actively engaged consumers of the entity's audited accounts, and rely on information prepared on the basis of standards to make decisions. Given capacity constraints, it is common for the

accounts preparation and audit to be done together (often without board members appreciating the difference) and for auditors to present the financial statements to the board members. With the focus on preparation of grant reports during the year, the annual audited accounts may be the only time that board members review the entity's financial reports as a whole.

I believe inclusion of consideration of their needs as stakeholders would be appropriate.

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

I agree that achievement of objectives, compliance with restrictions / regulations and long term financial health are of interest to users.

I posit that the term 'effectiveness' is superfluous if 'achievement of objectives' is already mentioned.

While many users look to the financial statements to provide information about efficiency and economy, I am concerned that over simplistic ratios relating to overheads or fundraising costs can be unhelpful.

I propose that users are interested to know 'how resources have been utilised', or simply 'how money has been spent' to achieve the objectives. Another area of key interest is the amount of restricted funds unused and carried forward to a subsequent period. This also facilitates reconciliation to grant or donor reports which is of key importance.

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

I agree with the issues as presented. Harmonisation of donor reporting requirements, most specifically in expenditure classification, would reap many benefits. Consistency between IFR4NPO Guidance and harmonised donor requirements would be the ideal end point.

Chapter 3 *What are the essential aspects of NPO Financial Reporting Guidance?* explains two key premises for developing the Guidance so that it supports the provision of information that is useful for accountability and decision-making.

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

In recent years, accrual accounting in the for-profit context has moved to a 'balance sheet' approach and sidelined the concept of matching. In the non-profit world, where accountability has more currency than financial performance, this results in clashes at the

conceptual level.

In light of this, the main challenge with the accrual approach relates to capital expenditure.

The concept of capitalisation and depreciation derived from the for-profit conceptual basis, matching the cost of an asset with the income that it generates over time. The (capital) expenditure usually precedes the associated income generated by the asset. Recognising the full cost in one go would result in apparent 'losses' whereas recognising the cost across the entire period that the asset generates income results in a smoother profit result, giving a 'true and fair' view.

In the non-profit context, funds may be given to pay for an asset. If the income is all recognised at once, but the expenditure is only recognised as the asset is depreciated, this results in an apparent 'surplus' which is misleading for many users.

The matching concept leads to the asset purchase being matched with the income that was given to pay for it, or the income being recognised to match the depreciation.

Many NPOs in East Africa expense donor-funded assets on purchase, and also capitalise them to the balance sheet with the credit to a 'Capital Fund', which solves some problems but creates others. A solution which embraces both the cash and accrual approaches to capex accounting, would be conceptually appropriate.

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

I see the main challenge as auditability, and avoiding the risk of the report becoming too long and formulaic.

Chapter 4 *How far can existing international financial reporting regimes assist NPOs?* highlights that limitations on time and resource mean that the Guidance must draw on existing frameworks. International financial reporting frameworks are proposed as the basis of the Guidance, with each having its advantages and disadvantages.

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

Yes, agree

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

Yes, agree

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

Yes, agree

Chapter 5 *Proposed way forward* puts forward a proposed model for developing the Guidance. The proposal uses the *IFRS for SMEs* Standard as a foundational framework and draws on full IFRS Standards, IPSAS and jurisdictional-level standards to develop the Guidance.

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

The main challenge is the conceptual framework for IFRS for SME which is targeted at for-profit entities.

Some aspects of IFRS for SME are unnecessarily complex for a majority of NPOs, such as pensions and financial risk disclosures as well as use of discounted time value of money calculations for multi year grants. In providing 'additional' guidance for NPOs, it would be good if some sections could also be deemed as not applicable for NPOs and excluded.

For instance, If IFRS for SMEs is updated to include the requirements of IFRS 16 on leases, recognising rent as 'right to use an asset' rather than a simple expense, this will also cause more confusion than clarity. In the for-profit world, the motive is to produce a similar profit result and balance sheet irrespective of the decision to lease or buy. This does not seem sufficiently relevant in the non-profit sector to warrant the additional accounting cost. I know of NPOs that have adopted IFRS16 and it has caused considerable problems for board members to make sense of the financial statements they are required to authorise - 'accountants making things complicated to make themselves look clever'.

I propose development of a conceptual framework specific to non-profits, then assessment of requirements of IFRS for SME against that conceptual framework. In this way sections can be retained, amended, added to or excluded to create Guidance that has the benefits of IFRS for SME without the disadvantages.