

International Financial Reporting for Non Profit Organisations

Response to the Consultation Paper

An alternative point of view

Throughout the IFR4NPO Consultation Paper there is an assumption that the production of a better set of standards for the preparation of NPO financial information will be useful for decision making and accountability.

In this submission, I argue that this is a sound assumption for some users of NPO financial reports, but it is also not relevant and potentially misleading¹ for other users².

I suggest that this assumption is very reasonable, given that the IFR4NPO consultation process is largely driven by the accounting profession and therefore reflects the profession's approach to "decision making and accountability".

In summary, better financial accounting standards for NPOs are likely to be beneficial to users who are focussed on the financial viability of the legal entity used by the NPO. These users are likely to include, government regulators, financial institutions, stakeholders who have a trading relationship with the NPO and some major donors.³

For those stakeholders who are interested in the NPOs activities that are in pursuit of the NPO's purpose, there are alternatives to the accounting profession's perspective and better financial standards may not be as useful for their decision making and accountability^{4, 5, 6, 7}.

¹ Gordon, T. P., Knock, C. L., & Neely, D. G. (n.d.). The role of rating agencies in the market for charitable contributions: An empirical test. *Journal of Accounting and Public Policy*, 28(6), 469–484.

² Hager, M. A. (2004, March 30). *Public Trust in the Public Face of Charities* [Text]. <http://www.urban.org/publications/1000630.html>

³ Bekkers, R., & Wiepking, P. (2007). Generosity and Philanthropy: A Literature Review. *SSRN Electronic Journal*, 36.

⁴ Sinclair, R., & Bolt, R. (2013). Third Sector Accounting Standard Setting: Do Third Sector Stakeholders Have Voice? *VOLUNTAS: International Journal of Voluntary and Nonprofit Organizations*, 24(3), 760–784. <https://doi.org/10.1007/s11266-013-9356-7>

⁵ Monteduro, F. (2017). The Adoption of Outcome-Related Performance Indicators in External Reporting: An Empirical Study. *International Journal of Public Administration*, 40(10), 860–874. <https://doi.org/10.1080/01900692.2017.1280824>

⁶ LeRoux, K., & Wright, N. S. (2010). Does Performance Measurement Improve Strategic Decision Making? Findings From a National Survey of Nonprofit Social Service Agencies. *Nonprofit and Voluntary Sector Quarterly*, 39(4), 571–587. <https://doi.org/10.1177/0899764009359942>

⁷ Lecy, J. D., Schmitz, H. P., & Swedlund, H. (2012). Non-Governmental and Not-for-Profit Organizational Effectiveness: A Modern Synthesis. *VOLUNTAS: International Journal of Voluntary and Nonprofit Organizations*, 23(2), 434–457. <https://doi.org/10.1007/s11266-011-9204-6>

Transparency and credibility issues/ increased comparability of NPO financial reports

The most serious threats to transparency, credibility, and comparability in NPO financial reports are:

- a. the lack of common definitions for the lines of account in NPO financial reports⁸, especially those that relate to “administration” and “fundraising”.
- b. International and inter-state cultural differences in what is understood by the terminology used in NPO financial statements.
- c. The inducements created by misguided notions of “efficiency” based on cross-NPO comparisons of various disclosures in their financial statements⁹.
- d. The notion that all NPOs can be measured with the same set of tools despite the vast differences between them in purpose, activity, size, sources of funds, and social context.

Needs of preparers and users

There is little doubt that clear and consistent NPO financial reporting standards would be of benefit to a range of preparers and internal users. The lack of comprehensive guidance makes the tasks of preparing financial statements subject to a wide range of judgements which currently are subject to local internal and regulatory differences across jurisdictions. As a result there is a wide variation in decisions around allocating transactions in a consistent way. New standards and more precise definitions would help solve these problems¹⁰. However, it seems clear that different judgements about how to allocate income and expenses to various lines of account / cost centres will continue.

Allocation issues

The key issues to be addressed are as follows:

- a. How can direct and indirect income and expenses be allocated in a consistent way?
 - i. In a large office the services, administration, fundraising staff and volunteers may share a range of support services such as rent, electricity, telephone, computers, printers photocopiers, cleaning services, security etc in order complete tasks that could be classified as “Services” “Administration”, or “Fundraising”
 - ii. In many NPOs staff and volunteers are engaged in tasks that could be allocated to “Services” “Administration”, or “Fundraising”. For example, a childcare worker may be required to receipt child care fees. Or, a personal

⁸ Flack, T., McGregor-Lowndes, M., Marsden, S., & Poole, G. (2014). Go your own way: Reporting of fundraising in Australian charity financial statements. *Third Sector Review*, 20(2), 9–22.

⁹ Flack, T. (2004). The Mandatory Disclosure of Cost of Fundraising Ratios: Does it achieve the regulators’ purposes? [Report]. QUT. <http://eprints.qut.edu.au/4555/>

¹⁰ *The Economics of Non Profit Accounting and Auditing: Suggestions for a Research Agenda*. (n.d.). ICNL. Retrieved 3 August 2021, from <https://www.icnl.org/resources/research/ijnl/the-economics-of-non-profit-accounting-and-auditing-suggestions-for-a-research-agenda>

- care assistant may be asked receipt fees and donations while attending clients' homes.
- iii. In many NPOs staff and volunteers deal with a wide variety of applications for funding. Applications to government, applications to Philanthropic Trusts and Foundations, applications to local government and submissions to local businesses. How can the revenue and the expenses associated with these activities be allocated these activities be allocated consistently?
 - b. How can direct and indirect income and expenses be allocated in a consistent way across financial reporting periods. Many fundraising activities are conducted over multi-year periods. For example, "capital campaigns" are often conducted in a series of phases over three years. The first year is often where relatively high costs are incurred with little income and in subsequent years higher income and lower costs are common. Accurate judgements about "efficiency" can not be made without considering the overall results of a multi-year campaign

Comments:

- a. I assert that the fundamental construct of the accounting discipline is the disciplined reporting of financial performance to the owners of capital and that this discipline is properly suited to reporting in commercial and government entities. I argue that while this discipline is totally appropriate in circumstances where the user is primarily concerned with the financial performance of the entity, this does not address the performance of the charitable purposes of the entity and is therefore not the concern of the great majority of stakeholders in NPOs.
- b. The major exception are the "trustees" or members of the governing bodies charged with the responsibility of the proper governance of the legal entity for which they are responsible. Apart from financial sustainability these accounts are not the key concern of most NPO governing bodies¹¹ Management accounting techniques are generally relied up to provide detail in areas of concern¹² to governing bodies.
- c. The debate about NPO Financial reporting standards has been going on for more than 20 years. The urgency of the reforms is likely to have been increased by two important policy and regulatory changes:
 - i. The continued out-sourcing by governments to NPOs of significant portions of the social services sectors has meant that there are now very large NPOs that have very different public accountability and transparency demands compared with the traditional local charities in which the members, participants and supporters are the main stakeholders.
 - ii. It is likely to be in the interests of government funding agencies to encourage smaller service providers to amalgamate and so be able to collect fewer - more comparable financial data. While this may be more

¹¹ Recent experiments using data collected from the web sites of two large nationwide charities revealed that of the 2,462 new donors who made on-line donations to their Winter Fundraising Appeals, only 4% visited the charity's AFRs available on the web sites.

¹² There are many examples of charities deliberately choosing a small number of expensive services rather than a large number of much less expensive and more cost-efficient services in the belief that those decisions better respond to their mission.

efficient, there is some danger in the loss of “local” personalised services provided by the smaller agencies.

- iii. The transfer of large numbers of NPOs from State and Territory regulatory oversight to the ACNC since 2013 has drawn attention to the different and sometimes contradictory regulatory requirements across jurisdictions. It seems clear that these inconsistencies need to be resolved. New NPO financial reporting standards are needed.

Recommendations

- 1. That any new standards be introduced slowly to allow time for volunteer treasurers and local accountants to learn of the new standards and to adjust to the new standards.**
- 2. That careful consideration be given to creating “tiers” which would be designed to relieve smaller organisations from implementing costly, major reform.**
- 3. That the recommendations of the Committee include a strong warning against the use of information provided under the new standard as the basis of “efficiency” measures.**

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