

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:

Nick Sladden on behalf of RSM UK

Email address:

Nick.Sladden@rsmuk.com

Description of your role if responding as an individual:

Head of Charities and Independent Schools at RSM UK

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

Provides audit, assurance and financial reporting services to charities and other not for profit entities in the UK including international, national and regional charities, leading independent schools and the UK education sector.

Jurisdiction(s) to which the feedback relates:

UK

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

(i) Accrual

Please provide any additional information on accounting basis in this box.

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

(iv) National GAAP

Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102)

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.

RSM UK is and audit and accountancy firm, engaging with non-profit organisation clients.

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)

Please provide in numerical format the approximate revenue per annum of your NPO in US\$

Please provide any further information on revenue in this box

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.

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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?

Whilst the proposed criteria for identifying NPOs captures important characteristics of the sector, we believe that there is ambiguity in its application. The consultation paper states that the guidance would be relevant for entities that meets some, or all of the criteria. The first criterion, being delivering services for public benefit, could capture a vast amount of corporate entities who provide services to benefit the public or society, such as pharmaceutical companies, who are likely not intended to be the users of the guidance. One way to overcome this may be to include a criterion that the entity should not have a primary objective to generate a financial return for the providers of resources.

A key criterion that we would recommend including would be that the entity was established for the primary purpose of public benefit and not primarily generating a financial return for providers of resources. How an entity is established, constituted, governed or regulated would be a key indicator of their non-profit status.

We would also recommend that the characteristic that profit / surpluses are directed for public benefit is tightened to refer to substantially all profits / surpluses. Many corporate entities, who are not the target audience of this guidance, make generous donations out of their profits for the public benefit, and this change in terminology would assist in removing this ambiguity.

Is it the intention of the writers of the guidance that it would scope in other sectors? Some sectors such as the pension sector or the registered social landlord sector would appear to meet some, if not all, of the characteristics, but it is unclear whether the guidance will also be appropriate for these entities.

Overall, we would welcome a tighter definition of a non-profit organisation, or additional guidance on how to apply the characteristics, or whether specific entities would be scoped out of 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.

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?

Whilst the charity may be accountable to others, we understand the primary users of the information contained in a NPO's financial and non-financial information to be those who fund the work of the charity to make a difference to society (resource providers), and those intended to benefit from that activity (beneficiaries). The needs of these users are therefore of paramount importance.

Alongside regulators and society in general, we propose that other stakeholders of NPOs include:

1) Employees – in order to promote the success of the entity, it is important that they have regard for the interests of their employees as it is they that deliver their services and ultimately assist the entity in achieving their aims. Therefore, they are a key stakeholder for NPOs.

2) Charities working in the same sector or with the same beneficiaries – it is expected that many charities will use the financial and non-financial information of other like-purposed charities to draw from their experiences and lessons they have learnt, identify efficiencies that they could replicate, or create collaboration opportunities.

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?

We agree with the proposed areas included in the consultation paper, subject to some comments below.

"Compliance with regulations" is all encompassing, and there will likely be a multitude of regulations in various jurisdictions that entities have to comply with, with a varying level of impact on the finances or operations of the NPO. Whilst we agree it is important for stakeholders to comprehend whether the NPO is complying with key regulations, reporting on compliance with all regulations, including those with a low impact on the NPO, would inhibit the ability to identify and understand the relevant information. So, we would encourage the provision of further clarification on the regulations to be reported on.

Also, in relation to long-term financial health, stakeholders will require information on the risks that the entity faces in sufficient detail that they can comprehend the likelihood and the impact of such risks, as well as the NPO's attitude towards risk. Coupled with this, it is important for stakeholders to understand:

- how management have assessed the NPO's current prospects and longer term viability, including over what time period they have made their assessment and what they have taken into account;
- the long term strategies and plans of the NPO.

Alternative areas that we would suggest would be required by stakeholders include:

1) The entity's attitudes and actions to the wider society, such as their environmental impact. There is increasing scrutiny on entities and their carbon footprint with entities increasingly being held to account for their energy usage and impact on the environment.

2) Strength of governance – we believe it is key that the strength of governance is commented on as good governance is paramount to the ongoing and long term success of a NPO. Therefore, it would be beneficial for the stakeholders of NPOs to report on their compliance with any relevant governance frameworks or codes.

We also have an additional comment on paragraph 2.18 which explains the required characteristics of the information produced, to meet stakeholders needs. We recommend that additional characteristics are also key in ensuring stakeholders needs are met. These include timeliness, completeness and neutrality.

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?

It is noted that one of the current issues is that donors are imposing their own financial reporting requirements on NPOs. We do not believe that this project will entirely negate this issue. Where NPOs have more than one resource provider / donor, it is unlikely that financial and non-financial statements would be in sufficient detail to meet the needs of every donor, and so it is likely that such separate reports to donors will still continue.

Another current issue with respect of accountability, is preparer bias. As NPOs sometimes see financial and non-financial statements as an opportunity to attract more donors, the information presented can often focus primarily on the positive outlook of the charity, and as such fails to provide a balanced review of the activities of the NPO.

The length of time presented in financial and non-financial information is typically 2 years, being the period reported on and a comparative prior period. Commonly, NPOs will receive multi-year funding which can impact on the levels of income recognised in some financial periods which could show a distorted perspective to stakeholders. Therefore, we believe that consideration should be given to whether presenting a longer period of time in both financial and non-financial information would be more appropriate for the sector, perhaps a five-year high-level summary note.

Finally, non-financial reporting has become extensive in order to meet the information needs of all stakeholders. The mass of information required in non-financial reporting often gives prevalence to immaterial disclosures which inhibit the ability to identify and understand relevant information. Also, there is a common theme amongst NPOs of the inclusion of explanatory information that remains unchanged year on year. This provides little more

information than could be obtained otherwise such as through their website, whilst obscuring the critical information.

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?

We do not foresee an issue with the accruals basis, provided it is recognised that smaller entities, where the cash basis of accounting is more appropriate, will not be drawn into this guidance.

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

We believe one of the main challenges with non-financial reporting is the reliability and integrity of the information provided. Often, the information included is difficult to verify, and in some jurisdictions, does not require auditing. This calls into question the accuracy of what is reported which would result in the stakeholders' requirements not being met.

In addition, there is likely to be a challenge with regards to incorporating the requirements of existing non-financial information disclosure under local jurisdiction legislation, particularly where there are existing differences between disclosure requirements for different sizes of entities. Is it the intention of the guidance to include a certain amount of information that is required by all NPOs, with those subject to local legislation providing more information as required?

Please also see comments previously made regarding the the implications of an abundance of non-financial information, and the potential bias in the preparation of non-financial information.

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?

The consultation paper identifies that there are some jurisdictional standards in circulation, such as in the UK, that are based on the IFRS for SMEs standard, which take into account a

multitude of NPO specific requirements. Whilst we agree that the IFRS for SMEs standard is an appropriate basis to use, have you considered whether it would be a more effective use of resources to base the guidance on one of these jurisdictional standards as the basis instead?

Something that is unclear in the consultation paper is what the starting point of the development of the guidance on non-financial reporting would be. The standards are relatively silent on this and given the varying legislation of different jurisdictions, it is unclear how this will be approached.

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?

Whilst the suitability of the current standards have been assessed for financial reporting, the narrative reporting and disclosure requirements in the existing standards against the needs of NPO stakeholders would also be a suitable criterion of assessment.

We believe the suitability of the cyclical update cycle should also be considered as part of the assessment. The NPO sector is fast paced, with new issues arising for the sector regularly, changing the needs of its stakeholders. Basing the guidance on a standard which is only issued every 5 years, whilst beneficial from a resource perspective, provides limited opportunity for updates. How do you plan to process changes on a timely basis to meet stakeholders' needs?

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, we agree that the high-level assessment carried out seems appropriate.

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?

We see the first challenge for the guidance is getting countries across the globe to accept the guidance and to willingly support and participate. In many jurisdictions, preparation of financial and non-financial information is mandated by legislation, which can also stipulate the framework to be applied. Hence, in some situations, to overcome this barrier, legislation would have to be amended, which may take time and resources.

Furthermore, there are instances currently in different jurisdictions where standards are adopted at different rates in different parts of the world. For example, for international standards to be applicable for UK entities, they have to be adopted by the UK Endorsement Board. There is a similar process for EU and other countries also. There is a risk that the different rates of adoption of the guidance around the world would reduce the comparability of financial and non-financial information.

The consultation paper is clear that the guidance will not be suitable in the short term for the largest of NPOs. Clarity over which NPOs it would not suit would be helpful. Likely, it is the larger NPOs which have the most stakeholders, and so should be held accountable. This is particularly important as these “large” NPOs make up a large proportion of activities in the NPO sector. For example, in 2020, the top 10 charities in the UK, made up 11% of the total income received by all 169,000 charities in the UK.

Another challenge we perceive is in the timing and frequency of updating the guidance. If periodic reviews are coterminous with the underlying IFRS for SMEs, with influence from jurisdictional standards and statements of recommended practice such as FRS 102 and the Charities SORP (FRS 102) respectively which are updated at least every five years, there could be periods where changes are made to the supporting material which is not reflected in a timely basis in the guidance. This could cause confusion and a lack of comparability amongst the sector.