Karen Sanderson – Head of Programme, IFR4NPO
Chartered Institute of Public Finance and Accountancy
77 Mansell Street
London E14 4HD
United Kingdom

17 September 2021

Dear Karen,

International Financial Reporting for Non-Profit Organisations: Consultation Paper Part 2: NPO-specific financial reporting issues

I am writing on behalf of the UK's Financial Reporting Council (FRC) in response to Part 2 of the above consultation.

Our response draws on the FRC's experience in developing UK and Ireland accounting standards. This includes FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, which addresses issues specific to entities that may be categorised as non-profit organisations (NPOs). As we outlined in our response to Part 1 of this consultation, we support the *IFRS for SMEs* Standard being used as the foundational framework. The requirements in FRS 102 are based on the *IFRS for SMEs* Standard, modified both in terms of the scope of entities eligible to apply it and the accounting treatments provided. The scope of FRS 102 includes entities defined as 'public benefit entities' and the standard includes requirements covering issues considered to be the most significant and relevant to such entities which are not addressed in the *IFRS for SMEs* Standard. These include concessionary loans, entity combinations, property held for social benefit, incoming resources from non-exchange transactions, and funding commitments. In many instances, the underlying concepts and pervasive principles of the Standard were drawn on to develop the requirements that address these issues.

Consistent with the option provided in the consultation paper, we have chosen to limit our responses to Part 2 to identifying the alternative treatments that we favour for each issue. For the most part, our preferred alternatives reflect the treatments set out in FRS 102, as supplemented by sector-specific statements of recommended practice. We consider that this approach works well in practice.

Our response also draws on outreach with UK stakeholders on the IFR4NPO project, as well as feedback received during the development of FRS 102.

We have previously provided a more detailed submission to Part 1 of the consultation; for Part 2 we provide a focussed response, responding primarily to those Specific Matters for Comment which request the identification of a preferred alternative. Our responses to selected questions in Part 2 of the Consultation Paper are included in the appendix to this letter. The views expressed in this submission are separate from and will not necessarily affect the FRC's future development and maintenance of UK and Ireland accounting standards.

We welcome the opportunity to contribute to your Guidance development process, both through our responses to Parts 1 and 2 of the consultation and our participation in the project's Technical Advisory Group. We believe the project has the potential to contribute towards addressing the gaps that exist in international financial reporting frameworks in relation to the NPO sector. To ensure that the initiative meets its aims, we would encourage the preparation of an impact assessment to enhance the Guidance development process.

If you have any queries or would like to discuss our comments in more detail, please do not hesitate to contact Jenny Carter, Director of Accounting & Reporting Policy (020 7492 2421, j.carter@frc.org.uk).

Yours sincerely,

Mark Babington
Executive Director, Regulatory Standards
Tel: 020 7492 2323
E-mail: m.babington@frc.org.uk

Appendix: Part 2 – NPO-specific financial reporting issues

Specific Matters for Comment 0
Completeness of list
0.a Is the list of NPO-specific financial reporting issues complete? If not, please provide information about the further issues that you believe are specific to NPOs, or issues that should be removed, together with supporting reasoning for the change(s) you propose?

Based on the prevalence of the issues in the UK, we agree that the list is complete, except for the following observations:

Accounting for investment/financial assets

No sector specific issues on this topic are given in Annex A of the Consultation Paper. Therefore, no comment is provided on this issue.

Foreign currency transactions

The financial reporting of foreign currency transactions is not specific to the sector and the matter raised arises as a consequence of donor reporting requirements. It is relevant to special purpose financial reports and therefore not in line with the scope of the project, which focuses on NPOs' general-purpose financial reports. For these reasons, we do not consider it necessary for the Guidance to cover this issue.

Service concessions arising in NPOs as operator

Contracts awarded in service concessions arrangements are not restricted to entities categorised as NPOs. For example, in the UK these arrangements typically involve public sector bodies contracting with private corporations. Therefore, we do not consider it is necessary for the Guidance to cover this issue.

Finally, to cover the accounting by grantors of service concessions arrangements, it will be necessary to extend the requirements in the foundational framework. FRS 102 was amended to extend the existing requirements in Section 34 of the *IFRS for SMEs* Standard based on the principle underpinning the accounting by operators of service concessions arrangements, similar to the finance lease model in IPSAS 32 *Service Concession Arrangements*.

Evaluation criteria
0.b Do you agree with the criteria used to evaluate the list of issues? If not, what changes would you make and why?

We agree with the criteria used to evaluate the issues.

Prioritisation of topics
0.c Do you agree with the topics prioritised for the Consultation Paper? If not, outline which topics should be added or removed and why?

Please see our response to 10.d in relation to non-financial reporting.

Specific Matters for Comment 1
1.d Please identify the alternative treatment that you favour for issue 1, and the reasons for your view.

In respect of issue 1: *Reporting entity and control (including branches)*, we support Alternative 2, which proposes the use of pragmatic methods of assessment such as the power to govern financial and operating policies to define control. This is consistent with the requirements of the *IFRS for SMEs* Standard.

Specific Matters for Comment 2
2.d Please identify the alternative treatment that you favour for issue 2, and the reasons for your view.

In respect of issue 2: *NPOs acting on behalf of other entities*, we support Alternative 2 which is based on the *IFRS for SMEs* Standard where decisions on agent and principal are made based on exposure to risks and reward.

Specific Matters for Comment 3
3.d Please identify the alternative treatment that you favour for issue 3, and the reasons for your view.

In respect of issue 3: *Non-exchange revenue*, we support an approach that brings together Alternative 1 and Alternative 4, which would require non-exchange revenue to be recognised using the principles from the *IFRS for SMEs* Standard, but with an exception to these requirements for gifts and services in-kind.

This approach is based on the *IFRS for SMEs* Standard, but modified to make the requirements less onerous and subjective. The implementation of a similar approach in the UK is such that a condition that allows for the recovery, in certain circumstances, of a resource by the giver does not necessarily prevent the recognition of revenue if repayment is not probable, which is generally considered to work well in practice.

Specific Matters for Comment 4
4.d Please identify the alternative treatment that you favour for issue 4, and the reasons for your view.

In respect of issue 4: *Grant expenses, w*e support Alternative 1, which would follow international standards (either IFRS Standards, the *IFRS for SMEs* Standard or IPSAS) and include additional guidance on recognition, measurement and disclosure including performance-related conditions.

Specific Matters for Comment 5
5.d Please identify the alternative treatment that you favour for issue 5, and the reasons for your view.

In respect of issue 5: *Measurement of non-financial assets held for social benefit,* we support Alternative 2, under which subsequent measurement of property, plant and equipment follows either the cost model or the revaluation model and an additional measurement basis (value in

use) is included under the revaluation model. This is consistent with the treatment set out in FRS 102 and we have found it works well in practice.

Specific Matters for Comment 6
6.d Please identify the alternative treatment that you favour for issue 6, and the reasons for your view.

In respect of issue 6: *Inventory held for use or distribution*, we support Alternative 3, which requires that inventory held for use or distribution is valued at cost, adjusted when applicable for any loss of service potential. This is the approach taken in FRS 102 for public benefit entities and we have found it to work well in practice.

Specific Matters for Comment 7
7.d Please identify the alternative treatment that you favour for issue 7, and the reasons for your view. In your response please consider the presentation of unrestricted reserves allocated for internal purposes.

In respect of issue 7: *Presentation of financial statements (including fund accounting)*, we support Alternative 2, which uses the *IFRS for SMEs* Standard and requires NPOs to use fund accounting. This approach draws on guidance from national requirements, specifically the use of fund accounting.

Specific Matters for Comment 8
8.d Please identify the alternative approach that you favour for issue 8, and the reasons for your view.

In respect of issue 8: *Classification of expenses – function or nature?* we support Alternative 1, which allows analysis by function or nature of expense. This approach follows IFRS Standards, the *IFRS for SMEs* Standard and IPSAS, allowing each entity to decide how best to present its expenses based on either their nature or their function.

Specific Matters for Comment 9
9.d Please identify the alternative approach that you favour for issue 9, and the reasons for your view.

In respect of issue 9: *Fundraising costs*, we support Alternative 1, which follows international guidance and allows organisations to decide whether the resulting information is reliable and relevant to its users. This approach allows organisations to use any of the international frameworks, given they have similar requirements.

Specific Matters for Comment 10
10.d Please identify the alternative treatment that you favour for issue 10, and the reasons for your view.

In respect of issue 10: *Narrative reporting*, we refer you to our response to Part 1 of the consultation as follows:

We support Guidance that includes non-financial information reporting. Doing so is necessary to meet the broader needs and expectations of users of NPOs' financial reports and allow them to obtain useful information.

The main challenge with addressing this area is its timing, as there are a number of international initiatives developing non-financial reporting frameworks. Consistent with the guidance on financial reporting, we believe any Guidance should leverage from these initiatives, rather than being developed in isolation from them. Over time, market participants are likely to converge on one or more of these frameworks as the preferred approach. Therefore, waiting for these initiatives to evolve would allow the project to leverage from the most generally accepted framework as the basis for the Guidance.

In the interim, we recommend that this area is addressed by developing a set of high-level principles for non-financial reporting. These could identify key areas for NPOs to consider when preparing non-financial information, signalling the key role it plays in NPOs' general purpose financial reports. These principles could then be used as the starting point for more detailed guidance.