

IFR4NPO Project

Discussion Summary and Requests

Practitioner Advisory Group meeting

15 June 2022
PAGED06



Acronyms

- ED – Exposure Draft
- ESG – Environmental, Sustainability & Governance
- IFR4NPO – International Financial Reporting for Non Profit Organisations (Project)
- IFRS for SME – International Financial Reporting Standard for Small and Medium Entities (issued by the International Accounting Standards Board)
- INPAG – International Non-Profit Accounting Guidance (the name of the Guidance being developed by the IFR4NPO Project)
- IPSAS – International Public Sector Accounting Standards
- PAG – Practitioner Advisory Group
- SORP – Statement of Recommended Practice

Status of this document

- The role of the Practitioner Advisor Group (PAG) is to present the diverse range of perspectives of different users of the guidance that the project aims to develop, giving input to the IFR4NPO Project Team and Technical Advisory Group.
- The PAG is not required to reach consensus and does not make formal decisions or take votes. Opinions shared by individual PAG members are not necessarily those of the entire PAG or the IFR4NPO Project.
- The recording provides a full verbatim account of the views of individual PAG members, any small group discussions are not captured.
- This document serves to record a summary of key opinions shared in the plenary sessions, in the form of a discussion digest, and requests to or from PAG members.

Attendance

Notes

The meeting was held online, chaired by Tim Boyes-Watson, and attended IFR4NPO Project team members Samantha Musoke, Karen Sanderson, Paul Mason and Phill Trotter in addition to the following PAG members:

Bages Petro, Carolyn Cordery, David Gilchrist, Dorothea Malloy, Genny Kiff, Hikmet Abdella, Kenneth Makanga, Marcia Brandon, Masayuki Deguchi, Mohamed Khlass, Nigel Davies, Oumou Wane, Oumou Wane Toure, Paul Winrow, Pesh Framjee, Philip McMinn Mitchell and Tshewang Penjor.



Session outline

1. Narrative reporting
2. Key numbers and terms
3. Reporting entity and control
4. Report from Donor Reference Group (DRG)

1.1 Narrative reporting: comments on approach

Discussion summary

- The financial statements will include notes, but the narrative report under discussion is separate from those notes.
- When talking about the performance objectives (in the second section of the proposed format), it will be important to see the connection from the mission or purpose. The overview (first section in propose format) includes commentary on purpose, so it is hoped that readers will see the link.
- Narrative reporting has helped to raise the bar, eg the UK Charities SORP included a requirement to talk about recruitment, induction and training of trustees, and setting a reserves policies. The need to report on it caused NPOs to actually work on it. Therefore it is important to keep some things mandatory. A 'must/should/could' approach could help people prioritise.
- Could the guidance that supports the INPAG on narrative reporting be expressed in simpler terms? The language in the paper is quite technical which works for a standard, but to promote adoption help to users may be needed. For example. 'performance measures' might be described as measures used to understand the achievements made in the reporting period.

1.1 Narrative reporting: comments on approach

Discussion summary

- Make it clear 'narrative reporting' is drafted by 'management'.
- Given the provision for NPOs to exclude some information if it is sensitive, it could be important to define what sensitive means to avoid misuse or this clause to mask poor performance.
- The current draft states that the use of this exclusion should be restricted to areas where there would be real risk to the NPO's staff, volunteers or service users, and that NPOs should state that there are aspects they are not reporting.
- The very act of an NPO stating it is making use of the exemption could create danger in some contexts. The draft text references humanitarian organisations in this context, but it is potentially more likely to be relevant for human rights organisations. An alternative approach is to keep the mandatory requirements to a minimum so that NPOs could choose to be truthful but vague in the way they describe their activities.

1.1 Narrative reporting: comments on approach

Discussion summary

- Some NPOs have performance objectives that are longer term, or may cut across reporting periods. This is to be expected, but the progress achieved towards those longer term goals should relate to the same period as in the financial statements.
- The 'risks and uncertainties' mentioned in the narrative report could include reference to going concern. In applying IFRS for SMEs, the notes to the financial statements should state whether the financial statements have been prepared on a 'going concern' basis. If they are not, there would be an expectation for that matter to be discussed in the narrative report, in the section relating to commentary on the financial statements.
- Determining going concern can be difficult and subjective, arguably more so than for a commercial business, especially in the context of NPOs dependent on short term grants. This could warrant commentary about going concern in the narrative report, irrespective of the basis used to prepare the financial statements.

1.1 Narrative reporting: comments on approach

Discussion summary

- There could be reference to social and environmental reporting and reporting on gender balance, diversity & safeguarding of service recipients and employees as issues that are important to readers.
- In order to make a closer link between the financials and the narrative, it could be helpful for NPOs to report on how much they spend on gender issues, safeguarding, climate etc
- Including some hard metrics or indicators would facilitate comparison
- Any social/climate text included in the 'narrative' could be directed to using guidance from the newly formed International Sustainability Standards Board (ISSB).
- Care should be taken not to conflate social responsibility reporting with performance reporting.
- If the mandatory minimum were to include additional areas such as climate, gender, metrics etc, it could become too onerous for some NPOs, so consideration could be given to a 2-tier approach and extending the transition period.

1.1 Narrative reporting: comments on approach

Discussion summary

- A member re-iterated a requirement to explain highest level financial amounts or changes. That is, 'management' should not fail to comment on the high impact financial numbers to only focus on what they wish to convey in terms of performance. Indeed, this is included in Para 2.7 of the paper, with the section of the narrative report titled: 'Analysis of the NPO's financial statements including significant changes and trends'
- A member expressed concern that the goal of comparability is undermined only mandate topic headings are mandated, rather than minimum standards of the information provided under each heading.

1.2 Narrative reporting: mandatory requirements

Discussion summary

- There is a balance to be struck between setting a 'high bar' and including all the areas that it would be ideal for NPOs to report on, against making the requirements so onerous that it becomes a barrier to adoption. INPAG is looking to establish a consistent base as a starting point.
- Given that INPAG itself is targeted to a specific group of NPOs, there is no appetite on the TAG for further tiering of requirements within INPAG. The goal is to have a minimum mandatory that is necessary for compliance, and the option to go above and beyond for those NPOs that choose to.
- The proposed mandatory disclosure requirements are drawn from existing standards. In the proposal, an NPO may include additional information about climate, gender, safeguarding, etc should they wish to. It is proposed that there will be a 'Specific Matter for Comment' in the Exposure Draft (ED)1 about whether any additional disclosures should be considered within the mandatory minimum.
- The opinion of the project team is that including mandatory requirements on these areas in 2022 ED1 would be premature, as the frameworks on ESG reporting (Environment, Sustainability and Governance) are still settling and have not been adapted for NPO sector. But, this may change by 2025.

1.2 Narrative reporting: mandatory requirements

Discussion summary

- The distinction between mandatory and voluntary is helpful
- Having examples which demonstrate the types of things we wish NPOs to report on may be more influential in driving practice than including them as mandatory requirements.

1.3 Narrative reporting: extended transition period

Discussion summary

- The list of mandatory requirements is already long, and the suggestions from PAG members could make it longer. This could take time, and is potentially difficult to verify, and that burden could be a barrier to adoption of the financial aspects in the guidance, apart from the narrative report. This supports providing a longer transition period for narrative reporting.
- Members in New Zealand, Australia, Barbados, UK & USA felt that, given that many NPOs will be coming to terms with requirements on the basics of financial reporting for the first time, it is advisable to extend the transition period on narrative reporting, acknowledging this as a journey. Those that have the capacity to, can adopt it earlier.
- Members in Uganda, Senegal, Ethiopia & UK felt that, given that the mandatory requirements are minimal, the high level of engagement during the development process, and that there is still time until 2025, NPOs have time to get ready. No additional extension period should be necessary.

2.1 Key numbers: restricted funds

Discussion summary

- A member expressed concern over the IPSAS definition in 2.3 Table 1, since it excludes situations where funds not used in accordance with the restriction are returnable. In practice, most funds given for a specific purpose do come with some requirement to return them if not used for that purpose. The proposal for INPAG in Para 2.6 addresses this by stating that a breach of the terms of restrictions will *usually* result in them being returnable, so the member was in agreement with the proposal.
- The use of the term 'assets' in the IPSAS definition was helpful, because the word 'funds' in the proposed definition might be construed to refer to cash.
- IPSAS23 is being re-written, hence important to refer to the new text there. The current direction of travel will likely remove the distinction between restrictions where funds are not returnable and conditions where they are returnable. Hence closer to the current ED proposal.
- But conditions could have an impact on recognition, so important to clarify this when the income recognition topic is addressed in ED2.

Requests

- Make a clearer distinction between the definition of restricted funds vs restricted assets.

2.1 Key numbers: restricted funds

Discussion summary

- To some, their interpretation of term 'restricted use,' may include restrictions placed by the board. The proposal in Para 2.5 uses the term 'externally imposed', and it might need to be clearer that this does NOT include funds set aside for specific purposes by the board.
- One member felt that users in Australia might read unintended meanings into the definitions that could cause confusion, and the definitions should be simplified.
- It is not clear how or if the definition distinguishes between temporary and permanent restrictions, in the sense of 'temporary' including specific purposes, periods, or events, and 'permanent' referring to endowments.

Requests

- Clarify that 'externally imposed restrictions' does not include designations by the board.
- Australian member to provide further details on the possible confusions that might arise.
- Definitions to be simplified.
- Clarify treatment of assets with permanent restriction such as endowments or legacies.

2.2 Key numbers: Equity

Discussion summary

- Equity in the for profit sector refers to shares, ownership rights, or access to net assets. What does this look like in a non-profit environment?
- Many members were not able to provide examples of equity in the non-profit context, and many expressed that it was not relevant or applicable for CSOs, NGOs according to their experience.
- One member expressed a preference for the term 'ownership rights' rather than equity as equity implies distributable profits and private benefit, whereas the character of this interest differs in NPOs.
- Cooperatives (which may be registered as non-profits) in Western Australia do allow for the distribution of capital to members.
- Micro-finance organisations in Palestine may have this type of equity, even if they are registered as non-profit institutions. The trading of shares may be more relevant than the existence of shares.
- Revolving funds are close to this concept. For example, a grant is given to establish a 'capital fund' for making loans. Or where a revolving fund is established to give pregnant goats to beneficiaries with the expectation that they return a goat to the 'fund' for another person to receive.

2.3 Key numbers: for FS prominence

Discussion summary

More Important

- Total income, expenses, and net assets
- Income from donors vs other sources
- In-kind donations, both received and spent / given out.
- Salaries and benefits
- 'Income for capital purposes' could be shown as a separate line on income statement if significant, with capital expenditure in the fixed asset note / cash flow statement.

Less important

- 'Unspent grants' would not have meaning for users in Australia
- Fundraising costs, as a functional cost category seems less relevant, but perhaps of interest to board members.
- Balances with directors would be best disclosed in the notes

Requests

- Provide a definition that distinguishes between grants and donations

2.3 Key numbers: for FS prominence

Discussion summary

- Views on 'programme vs admin' were split, with some members expressing it as important for users, and others sharing that it could have unwanted side effects in terms of unhelpful for misleading comparisons.
- Evidence from research undertaken by the UK charity regulators is that the public (wrongly) use fundraising expenses/ administration costs and chief executive salaries as a proxy to understanding the difference a charity is making and the impact it has.

3.1 Consolidation: when inappropriate?

Discussion summary

- Consolidation is not on the list of top 10 sector specific topics to be addressed, but is relevant in the context of reporting entity. Is there a conceptual basis for NOT consolidating?
- One member argued that it was even more appropriate in the non-profit sector than in the for-profit. Consolidations because organisations have the same mission and are achieving the same purpose. Some that are not required to consolidate, eg Greenpeace, Plan, WWF the want to show the true size, scope and remit of the operations around the world.
- There can be challenges with funder requirements. Eg EU funders may be reluctant to provide funds to EU entities if their financials are consolidated into results of a UK entity, since it implies the EU entity is controlled by the UK entity.

3.1 Consolidation: when inappropriate?

Discussion summary

- In UK, the approach is to allow smaller entities to choose not to consolidate but the income limit for charities (£1m in England and Wales) is lower than that of private companies (£6.5m turnover) reflecting the importance put on accountability by charities for donor funds.
- It might not be appropriate where a charity can hide going concern issues in a larger group, where there is not the underwriting assurances that might be presumed in the for-profit sector.
- Religious charities in Australia are exempt from a number of regulatory and reporting obligations. There may be opportunities for human services organisations to be consolidated up into religious charities, which would mean they would not report.
- Not suitable when they are separate entities. For example, an INGO provides 100% funding to a national NGO, and effectively 'controls' it, but consolidation would not be appropriate in this context.

3.2 Consolidation: faithful representation & relevance

Discussion summary

- Need to explain the terms to preparers 'faithful representation' and 'relevance'
- The user focus is appropriate

3.3 Consolidation: consultation on alternative treatment?

Discussion summary

- Perhaps consult on whether in terms of INPAG adoption consolidation is optional and see what the response is across the world

4.1 Donor Reference Group

Discussion summary

- There was no time to hear reflections or reactions to the report out from the Donor Reference Group