INTERNATIONAL FINANCIAL REPORTING
FOR NON PROFIT ORGANISATIONS

Supplementary Information: IFR4NPO Additional Project Information

This document provides additional material to support aspects of the Consultation Paper. This includes the Preface (Project Background and Guidance Development Process), Part 1 (Project Background, Historical Context and Defining NPOs) and Part 2 (Historical context).

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Defining Non-Profit Organisations

1. Context

1.1 Understanding which organisations are NPOs and might benefit from the Guidance is an important question both for the project and for regulators who might seek to use the Guidance in their jurisdictions.

1.2 NPOs need to be defined so that in considering the accounting issues, the potential application to organisations is known, i.e. which organisations might benefit from the Guidance. With the breadth of the sector and differences in jurisdictions, a single definition that accommodates the range of organisations that might be expected to fall within the scope of the Guidance is challenging.

1.3 Finding a single definition of the entities that might use public sector accounting standards was a challenge also faced by the International Public Sector Accounting Standards Board (IPSASB). The Preface to the IPSASB Standards sets out the scope of the Standards and does this in a narrative form to give guidance as to the entities expected to be covered by the Standards. It says:

> 'The IPSAS are designed to apply to public sector entities[1] that meet all of the following criteria:
> a) Are responsible for the delivery of services[2] to benefit the whole of the public and/or to redistribute income and wealth;
> b) Mainly finance their activities, directly or indirectly, by means of taxes and/or transfers from other levels of government, social contributions, debt or fees; and
> c) Do not have a primary objective to make profits.

1.4 An approach that adopts a narrative set of descriptions that characterise the purpose and objectives of the organisation is proposed in Part 1: Section 1. These characteristics seek to draw out those organisations that in essence, might be for-profit entities and those organisations that might in essence be public sector entities and not anticipated to fall within this Guidance.

2. Previous Research

2.1 In 2014, a report issued by the Consultative Committee of Accountancy Bodies in the UK (CCAB Report[3]), the definition of NPOs was reported as an issue by survey respondents. The report described terms to describe not-for-profit entities; NPOs, non-government

[1] Paragraph 1.8 of *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* identifies a wide range of public sector entities for which IPSASs are designed.
[2] Services encompasses goods, services and policy advice, including to other public sector entities.
[3] International financial reporting for the not-for-profit sector – A study commissioned by CCAB published February 2014.

organisations (NGOs), charities, public benefit entities, voluntary organisations, donee organisations, membership organisations, professional associations, societies, mutual and non-investor-owned social enterprises. Importantly it noted that these terms can have different meanings in different jurisdictions and to that contained in law.

2.2 The report examined differences between NPOs, for-profit entities and public sector entities across four factors; ownership (including constitutional form and management control), beneficiaries, social purpose and financing, as a way of differentiating organisations.

2.3 Academic studies and statistical guides have sought to develop international classification frameworks for NPOs by focussing primarily on the structural and operational features of entities. These include the System of National Accounts developed by the United Nations and *The International Classification of Non-profit Organisations* from the Johns Hopkins Institute for Policy Studies.[4] The common approach of these frameworks is that an entity is deemed to be an NPO if it is:

- An organisation – institutionalised to some extent even if not a legal entity;
- Self-governing – in control of its own activities;
- Private – institutionally separate from government;
- Voluntary/non-compulsory – participation in the entity's activities and contributions to it are a free choice; and
- Non-profit distributing/significantly limited in distribution of surpluses – any profits or surpluses generated are not returned to owners for private gain and the entity is not primarily guided by commercial considerations.

2.4 In addition to examining these structural and operational features, a more granular classification of NPOs can also be made based on:

- the activities that the NPO undertakes – is it is focussed on providing services related to for example healthcare, education, sanitation, housing or advocacy;
- the sources of its funding – does the entity receive funding only from a small number of local or national donors, or does it manage grants on an international level and in turn awards sub grants to other entities; and
- the locations in which it operates – does the entity provide services in only a single local area or region, has it a national focus, or is it operating across borders/internationally.

2.5 These classifications have strongly influenced the NPO broad characteristics proposed in Part 1: Section 1. These broad characteristics include for example public benefit objectives and the non-distribution of surpluses. A greater focus has been placed, however, on economic events and transactions that are relevant to the development of principle-based financial reporting guidance. These include a focus on voluntary donations and grant funding

[4] See Salamon, L. M., & Anheier, H. K. (1996). The International Classification of Nonprofit Organizations: ICNPO-Revision 1, 1996. Baltimore, Md, Johns Hopkins Institute for Policy Studies, and also https://unstats.un.org/unsd/nationalaccount/docs/UN_TSE_HB_FNL_web.pdf

and restrictions that can be placed on such funding, and how assets are held and used to deliver services rather than for cash-generation.

3. Jurisdiction approaches

3.1 At the jurisdictional level there is often a focus on legal concepts that are not as easily or readily able to be applied internationally. This includes concepts such as "charitable purposes" that have a specific meaning within certain jurisdictions. In addition to not being internationally applicable, these legal concepts can also exclude entities within jurisdictions. For example, in some jurisdictions an entity may not be seen as an NPO if it is providing services that are narrowly focussed on a specific group.

3.2 As well as regulation and taxation, financial reporting is an area that highlights how jurisdictions can take their own approach to defining which entities are seen as NPOs. At a jurisdictional level there can be a focus on whether an organisation meets the definition of a "public benefit entity", and the extent that the entity is permitted to generate profit/surpluses as part of meeting its primary objectives and then distribute these to owners or members. While this reflects aspects of the international classification framework, it is also clear that each jurisdiction defines what an NPO is based on their own requirements and the wider legal and regulatory framework in place.

Technical box 1: Examples of jurisdictional level definitions of NPOs for financial reporting

Jurisdiction level definitions of NPOs for financial reporting guidance

Canadian GAAP incorporates a test of public benefit purpose but also focuses specifically on the not-for-profit characteristics of an entity and in particular financial returns, defining a not-for-profit organisation (NFPO) as being: *"an entity, normally without transferable ownership interests, organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose. An NFPO's members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization." Preface to the CPA Canada Handbook - Accounting, paragraph 3(c)* – April 2019

In New Zealand's accounting standards framework for for-profit and public benefit entities (both not-for-profit and public sector entities), defines public benefit entities *"as reporting entities whose primary objective is to provide goods or services for the general public or social benefit and where any equity has been provided with a view to supporting that primary objective rather than with a view to providing a financial return to equity holders." External Reporting Board Standard A1 – Application of the Accounting Standards Framework – Appendix A* - External Reporting Board New Zealand – May 2019

The Financial Reporting Council in the United Kingdom when developing FRS 102 (which also applies to those entities that are not profit oriented) noted that a public benefit entity is: *"An entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any equity is provided with a view to supporting the entity's primary objectives rather than with a view to providing a financial return to equity providers, shareholders or members." FRS 102 The Financial Reporting Standard Applicable in the UK and the Republic of Ireland* - Financial Reporting Council – March 2018

3.3 Jurisdictions also often require NPOs to apply different financial reporting standards based on their size and complexity. This is usually determined using financial statement measures such as how much income an entity receives per year or its level of expenditure. From an international perspective what is deemed to be a relatively small NPO in one jurisdiction may be seen as large in another. It will be for individual jurisdictions to determine, based on local circumstances, to whom the Guidance applies where it is adopted.

3.4 This Guidance, using its broad characteristics approach, has been prepared to be as widely adopted as possible and not to limit its international applicability. Practically as outlined in Part 1: Section 5 it is proposed to be focused on those entities that have the most pressing needs.

Historical context

1. 2014 CCAB Report

1.1 In 2013, the Consultative Committee of Accountancy Bodies (CCAB), the coordinating body for the UK and Ireland's Professional Accountancy Organisations, funded an independent study on the need for international financial reporting standards for NPOs.

1.2 The study, which was focused on NPOs that are;

- constituted on a not-for-profit basis; and
- self-governing; and
- established for public benefit

included an on-line survey in English carried out in late 2013. The survey included 19 core areas, with both closed and open questions that allowed narrative comments. It was circulated widely through international contacts held by the CCAB steering group

1.3 There were 605 usable responses with direct experience of NPO financial reporting in 179 countries. These responses contained a lot of detail, with two third of respondents completing most of the narrative questions. Responses came from NPOs of all sizes.

1.4 The resulting report published in 2014, built a robust evidence base for the need for an international reporting standard for the NPO sector, through a survey in which 72% of 605 respondents across 179 countries agreed that such a standard would be useful.

1.5 The study raised several issues, notably the diversity of requirements placed on NPOs. These were often linked to the NPO's legal form, for example, many jurisdictions placed requirements on NPOs structured as companies which did not apply to other NPOs. The report noted that the scope of NPO's could be wide (See section 4 below).

1.6 The study also noted that accounting requirements ranged from very specific NPO standards to no standards at all. For example the study highlighted that the UK Charities SORP (Accounting and Reporting by Charities: Statement of Recommended Practice) is very detailed and specific, in Australia a sector neutral approach was adopted with some guidance for NPOs, and in South Africa no separate accounting standards were issued and NPOs applied IFRS. The study also noted that where countries did require application of IFRS, the extent of application especially to small NPOs was raised as questionable. It also identified areas of difference in accounting treatments in specific areas. These have been incorporated into the 'long list' of issues included in Annex A to Part 2.

1.7 The study set out a number of options to address these issues, including both specific international accounting standards and guidance. However, it concluded that more analysis

and discussion would be needed by interested parties to determine the best way forward, with the findings of the report having the potential to inform this debate.

2. ACCA Companion Guide

2.1 In 2015, the UK the Association of Chartered Certified Accountants (ACCA) issued a Companion Guide '*Companion guide for Not-for–profits to the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)'*. The Guide was principally authored by Nigel Davies who was the Head of Accountancy Services at the Charity Commission in the UK and has a deep experience of charity accounting in the UK.

2.2 The guide was written in response to the lack of formal guidance to help NPOs prepare financial accounts under a robust, but appropriate framework. The foreword to the guide says *'….as a consequence of the IASB's focus on for-profit organisations, there are times when the outcome of applying the [IFRS] SME Standard to not-for-profit organisations will not provide a perfect representation of the results of those entities'*.

2.3 The objective of the Companion Guide is to provide assistance to not-for-profit entities that may wish to prepare reports on the basis of the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs). It identifies a number of issues for not-for-profit organisations and seeks to provide guidance to sit alongside the IFRS for SME's standard to address those issues. These issues have also been incorporated into the long list of issues included in Annex A to Part 2 of the Consultation Paper.

3. IFASS Working Group

3.1 The International Forum of Accounting Standard Setters (IFASS) is a grouping of national accounting standard-setters from around the world, plus other organisations that have a close involvement in financial reporting issues. Following a meeting of IFASS in April 2016, an informal grouping of some of these standard setters and other organisations with an interest in not-for-profit reporting was formed.

3.2 The Group has 10 member countries represented and is chaired by CIPFA, who also provides the Secretariat. Consistent with the position of the IFRS Foundation (set out above), the IASB participates as an observer. The group has been discussing the most pressing issues being encountered by national standard setters for this sector.

3.3 The Working Group developed a list of issues and brought together information from Working Group participants about the various accounting treatments in their jurisdictions. The issues identified by the Working Group have been incorporated to the 'long list' of issues in Part 2: Overview of the Consultation Paper.

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Project Background

1. Current financial reporting context

1.1 International Accounting Standards have been available for the private sector since the 1970s and the public sector since the 1990s. They have provided a focal point for global convergence and brought tangible benefits in terms of raising funds and providing decision-useful information.

1.2 There are no international accounting standards for non-profit organisations, and few countries have their own sector specific guidance. Financial statements are therefore prepared using standards developed for the private or public sectors.

1.3 These do not generally address issues and concepts specific to the not-for-profit sector, such as accounting for grants. This can lead to differences in how the same transactions are treated within and between jurisdictions. There have also been issues around the adequacy of narrative reporting.

1.4 The disparities in reporting can lead to lack of transparency and undermine the relevance and credibility of NPO financial statements. Differences can also mean that there are failures in accountability and the provision of decision useful information. This can lead to a breakdown in trust and issues such as 'double funding' where the costs for the same activity are claimed against multiple grants.

1.5 NPO funders often use the audited accounts of potential grantees as part of their due diligence processes, but the staff responsible may struggle to find the information they need to make judgements about the organisation's financial heath and capability. The wide variety of formats and treatments also makes it harder to make comparisons between grantees. This slows down the grant making process and makes it less reliable.

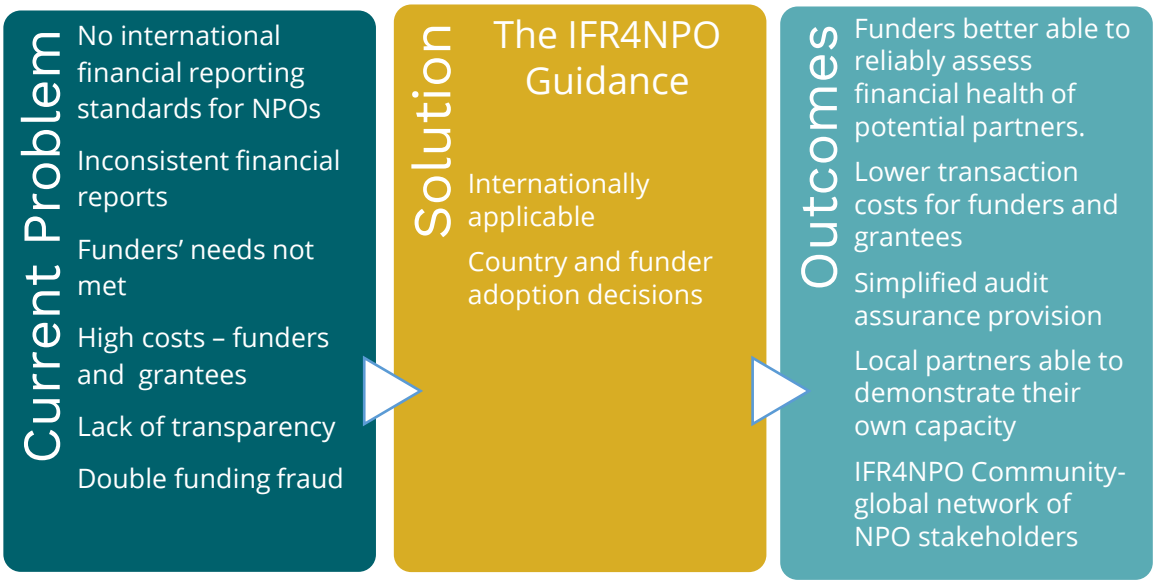
1.6 When funders request financial information as part of grant accountability, they often specify their own accounting or reporting requirements, creating further complexity and duplication of work for NPOs.

1.7 As a result, NPOs currently face a multiplicity of regimes which require financial information to be prepared under different accounting and financial reporting standards, causing considerable time and resources to be spent in a wasteful and inefficient system.

1.8 These problems have been raised across the world for a number of years and are now exacerbated by the increasing number of organisations operating globally or on a more restricted geographic basis but still internationally across jurisdictional borders. The issues have been reported through academic studies, by standard setters and by members of the NPO community, including donors.

1.9 Despite these findings, neither the International Accounting Standards Board (IASB) nor the International Public Sector Accounting Standards Board (IPSASB) has had the resources to develop guidance for NPOs given that developing such standards is not within the remit of either body, coupled with pressures on their respective agendas.

Chart 1.1 Project Context



2. Project outcomes, outputs and benefits

2.1 The IFR4NPO project can play a key role in strengthening the accountability of NPOs in every country across the world. The project seeks to enable a better managed, more effective and accountable sector, with greater credibility and trust and lower costs of financial reporting.

2.2 The project seeks to support improvements in NPO accounting practice with the goal of higher quality financial information for internal and external users, stronger internal control, and improved cost recovery.

2.3 Greater consistency in reporting will provide a basis for comparison between organisations and jurisdictions. This will improve the environment for the effective regulation of the sector, both nationally and internationally.

2.4 With funders better able to reliably assess the financial health of potential partners, higher quality more reliable financial reports should also lead to lower costs for funders and grantees seeking grants or donations. Improved financial reporting should also

allow grantees to demonstrate their capacity and take advantage of simplified audit assurance arrangements.

2.5 To deliver these outcomes, the central output of the project is a single set of financial reporting Guidance for NPOs that can be applied internationally. The Guidance will provide a set of tools to help NPOs prepare their accounts. This Guidance will take account of the accountability and general information needs of NPO stakeholders.

2.6 This concept of accountability includes a broader accountability to civil society as well as specific stakeholders. This type of accountability is not unique to NPOs. For example, in the public sector there is a concept of public accountability that comes from the provision of services from compulsory taxation revenues. In the private sector public accountability is deemed to exist where an entity has publicly traded debt and shares. Public accountability in this case is essential to the efficient and effective operation of public markets in such financial assets and services.

2.7 The Guidance will help national standard setters where no sector specific accounting standards or guidance exists. It will provide the starting point for a more coordinated approach that prevents differences emerging amongst jurisdictions.

2.8 In the longer term, the Guidance, if developed using robust standard setting processes, can form the basis for more comprehensive international NPO standards if there proves to be a demand for, and development resources available.

2.9 Materials including training resources to help NPOs adopt the Guidance once it has been finalised are the other key project outputs. The project is seeking to build a diverse global community of those with a stake in NPO financial reporting. This outcome is an important enabler for the development and maintenance of sustained strong financial management into the future.

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Developing the Guidance

1. Project Arrangements - Partners and contributors

1.1 The project is being delivered by a partnership between Humentum and the Chartered Institute for Public Finance and Accountancy (CIPFA).

1.2 CIPFA is a UK based charity with a Royal Charter, which has the aim of strengthening public financial management and governance. CIPFA is the only professional accountancy organisation focusing on public and not-for-profit sectors internationally. CIPFA has unique standing setting roles for local government and charities in the UK. CIPFA is leading on the technical development aspects of the project.

1.3 Humentum provides training, consulting and convening around the world for non-profit organisations. Humentum provides practical solutions, expertise and professional communities for social sector organisations to strengthen their core capabilities and achieve greater impact. Key areas of focus are compliance, financial management, programme management and people development. Humentum is leading on the stakeholder engagement aspects of the project that includes NPOs, funders, regulators, governments, and professional accountancy bodies

1.4 Both organisations are respected in their fields and have relationships with a wide range of sector stakeholders. This includes NPOs, funders, standard setters and the accountancy community, whose buy-in is necessary for success.

1.5 The project team has a Steering Group that is providing oversight. The Steering Group has three non-executive members and two executive members. Further information about the Steering Group and its role can be found at https://www.ifr4npo.org/about/project-governance/.

1.6 The project is being funded by contributions. The Ford Foundation and the Open Society Foundation have provided seed funding that has enabled the project to commence and for this Consultation Paper to be produced.

1.7 The costs of completing the project will be provided by further grants and donations by multiple donors. The project is being managed so that no one contributor can influence the development of the Guidance.

2. Advisory Groups

2.1 The project has convened international professional Advisory Groups to support the Guidance development process: The Technical Advisory Group brings the rigour of national standard setters, and the Practitioner Advisory Group draws on the experience and perspectives of a diverse range of sector stakeholders from all over the world

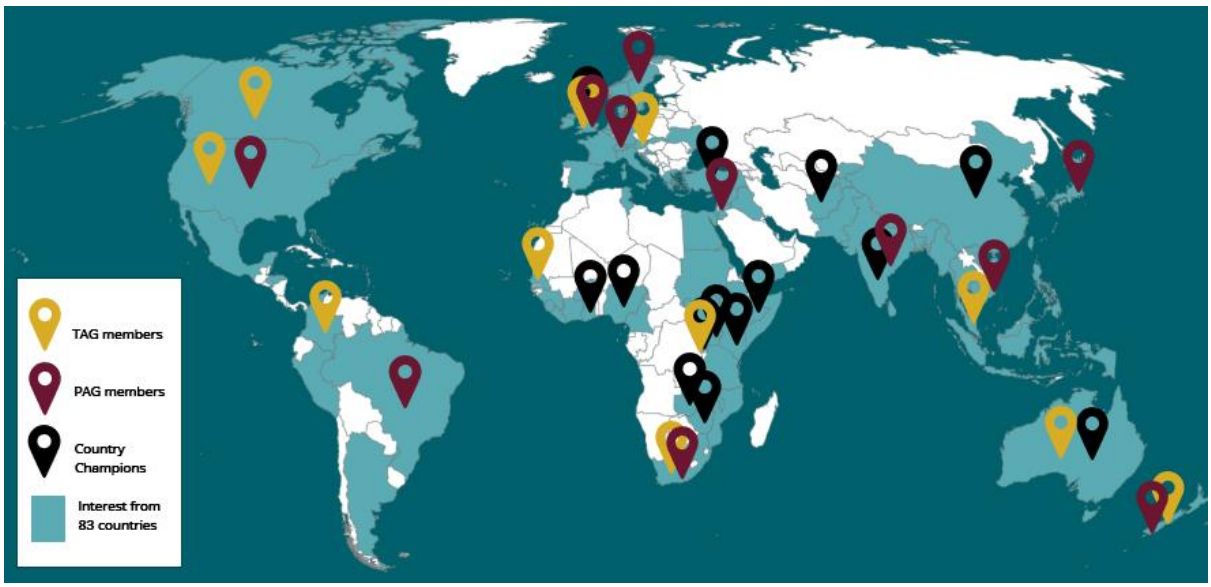
2.2 CIPFA chairs the Technical Advisory Group (TAG). The TAG membership is drawn from several national standard setters or their nominee. The TAG also includes a formal observer from the International Accounting Standards Board. TAG members sit as individuals rather than as authorised representatives of their individual bodies and participate due to their expertise in standard setting. Their role is to provide technical rigour in its advice on the development of the Guidance. Meetings are public with the meeting papers, recordings of the meetings and a summary of the main points available on the project website. More information about the TAG and its membership can be found at: www.ifr4npo.org/technical-advisory-group/.

2.3 Humentum chairs the Practitioner Advisory Group (PAG). and. The Practitioner Advisory Group is drawn from multiple stakeholder groups that have an interest in NPO financial reporting from across the world. This includes NPOs, funders, auditors, academics and regulators. Their role is to provide advice on the practical issues associated with the development of the Guidance. As with the TAG, meetings are a matter of public record, with meeting papers, recordings of meetings and a summary of the main points available on the project website. More information about the PAG and its membership can be found at: www.ifr4npo.org/practitioner-advisory-group/.

3. Delivery and engagement

3.1 The process of developing the Guidance is designed to be as collaborative and inclusive as possible. This is to properly reflect the concerns, issues and needs of the NPO community. The aim is to maximise the opportunity for the Guidance to be relevant to the sector and usable by all stakeholders. Contribution and participation is actively encouraged.

Chart 3.1 Stakeholder engagement – position as at 30 June 2020



3.2 Country Champions from across the world have been appointed to support awareness raising and provide information about the project. These localised actions are being supported by materials, including webinars, provided by the project team and discussion forums available on the project website at: www.ifr4npo.org/forums/. The project is aiming to keep the NPO community informed about key developments and involved in discussions so that it can have a say about matters that are of greatest concern.

3.3 Technically, the Guidance is being developed following the tried and tested methodology used in international accounting standard setting in the private and public sectors. This follows the steps of Consultation Paper and Exposure Draft before issue of formal guidance. This will mean that the Guidance is being developed in a robust and transparent manner.

3.4 The Technical Advisory Group considers proposals for the documents that are formally issued by the project and provides advice on their content. All these papers and the deliberations of the TAG are in the public domain. Advice is also sought from the Practitioner Advisory Group to get a perspective from the varied stakeholder groups on proposals. The advice from both bodies are used to further develop the content. There is a feedback loop between the bodies.

3.5 Following the issue of this Consultation Paper, and in the next phase, the Exposure Draft, there will be a series of regional consultation meetings. These will be designed to engage on a range of points from formal documents issued and to seek feedback. This feedback will complement formal written consultation responses and provide the opportunity to interact with the NPO community.