



## Practitioner Advisory Group

### AGENDA ITEM: PAGCP01- 5

December 5-6, 2019 - Nairobi, Kenya

### Developing the Guidance

<b>Summary</b>	The paper sets out options for developing the Guidance.
<b>Purpose/Objective of the paper</b>	The paper sets out options for the format of the Guidance, and also asks for views on whether the Guidance should be based on IFRS for SMEs.
<b>Other supporting items</b>	PAGCP01 –04 Project Scope and Objectives
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<b>Actions for this meeting</b>	<b>Advise</b> on the options for the Guidance for input to the TAG.
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## Developing the Guidance

### 1. **Background**

- 1.1 The NPO sector is hugely diverse. For those that benefit from the operations of these organisations that is a major strength, however, this then poses huge challenges in developing and setting standards specifically for the sector.
- 1.2 To date, addressing the differences that NPOs have with the for-profit and public sector organisations has been dealt with in a variety of ways across the world; this includes bespoke standards/guidance, interpretations within national standards or no specific guidance or interpretations. There is no common approach to providing guidance even where issued guidance is based on national or international standards.

### 2. **Format Options**

- 2.1 The project is not proposing to develop a full set of standards specifically for the NPO sector. To do so would require significant time and resources, over and above that allowed for in this project. To give an idea of the effort involved, it has taken IPSASB more than 20 years to develop its increasingly complete set of financial reporting standards for use by public sector entities around the world. Based on this experience, developing a separate suite of international accounting standards specific to the NPO sector would be time-consuming and costly given the diversity of organisations and accounting practices.
- 2.2 Instead it is proposed that Guidance is developed by harnessing an existing international reporting framework, in order to use its hierarchy, structure and legitimacy. This will reduce the development time. In adopting this approach, in order to add value most quickly, it is proposed to focus the development of the Guidance on those sector specific issues that are most pervasive across the sector.
- 2.3 The Guidance developed by this project needs to be usable and accessible to the range of stakeholders that have relationships with or have a vested interest in the sector, including preparers, auditors, professional bodies, funders, beneficiaries, governments and regulators (the NPO community) and meet their needs. The format of the Guidance is therefore important and this will be specifically addressed in the Consultation Paper (CP).



## International Financial Reporting for Non Profit Organizations

2.4 The options potentially available for the format of the Guidance therefore need to be considered. Once developed these will provide a framework for the respondents to the CP. This will provide the opportunity to better understand what stakeholders need. Based on examples from around the world, there appear to be three broad potential options for guidance:

- Option 1a:** Develop stand-alone Guidance that incorporates the requirements of a suite of international standards, and provides guidance and interpretations relating specifically to the NPO sector;
- Option 1b:** Develop stand-alone Guidance that incorporates the requirements of a single international standard (such as IFRS for SMEs), and provides guidance and interpretations relating specifically to the NPO sector;
- Option 2:** Develop a 'companion guide' that sits alongside a single, or suite of existing international standards that can be used by practitioners in addition to the standards themselves; and
- Option 3:** Add interpretations and additional explanatory text to a single or suite of existing international standards using explanatory text boxes and/or annexes.

2.5 Each of these approaches can be illustrated as follows:

- Option 1a – New Zealand has developed standards that cover both public sector bodies and NPOs (collectively known as Public Benefit Entities). Their guidance for bigger PBEs is based on individual standards from the suite of International Public Sector Accounting Standards (IPSAS), with terminology changes, additional examples to extend the applicability of the guidance to NPOs.
- Option 1b - the UK Charities Statement of Recommended Practice (SORP)<sup>1</sup> has been developed as a standalone document based on the UK Financial Reporting Standard for Small and Medium-sized organisations (the UK equivalent of IFRS for SMEs).
- Option 2 - the Association of Chartered Certified Accountants issued a "Companion Guide for Not-for-profits to the International Reporting Standard for Small and Medium-sized Entities"<sup>2</sup> in October 2015.
- Option 3 - Public Sector Internal Auditing Standards<sup>3</sup> were issued in 2017. This is based on the Institute of Internal Auditors (IIA) International Professional Practices Framework (IPPF).

2.6 In evaluating the options, there are specific considerations about how the Guidance will be viewed by the auditing community. With a focus on supporting the preparation of General Purpose Financial Statements, the Guidance should be capable of informing the work of auditors in reaching opinions on financial statements. In executing this project there will need to be engagement with the audit community to understand how the Guidance,

<sup>1</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/354885/sorp05textcolour.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/354885/sorp05textcolour.pdf)

<sup>2</sup> [https://www.accaglobal.com/content/dam/ACCA\\_Global/Technical/smb/companion-guide-for-not-for-profits.pdf](https://www.accaglobal.com/content/dam/ACCA_Global/Technical/smb/companion-guide-for-not-for-profits.pdf)

<sup>3</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/641252/PSAIS\\_1\\_April\\_2017.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/641252/PSAIS_1_April_2017.pdf)



# International Financial Reporting for Non Profit Organizations

given its non-mandatory status, will best achieve respect and traction in the audit community.

- 2.7 Developing stand-alone guidance incorporating the requirements of a suite of international accounting standards or a single standard (IFRS for SMEs) (Options 1a and 1b) would likely be a more onerous undertaking than the other two options to ensure that the resulting Guidance is cohesive and entirely self-standing. To achieve this, the Guidance may need to go beyond the topics that get shortlisted for inclusion.
- 2.8 Based on initial discussions with the IFRS Trustees, the Secretariat believes that Option 2 (the 'companion guide' approach) may prove easier to implement in practice, and could also potentially provide more flexibility in addressing NPO needs. A companion guide can be specific to the shortlisted issues and more easily developed over time. The issues involved in using IFRS for SMEs as a basis for Option 2-style guidance are explored further in the next section.
- 2.9 Both the Secretariat and the TAG consider that Option 3 also has merits.
- 2.10 Whilst Option 1(a) and perhaps to a slightly lesser extent Option 1(b) are likely to be particularly onerous the TAG advised that all three options with their advantages and disadvantages should be presented in the Consultation Paper. However, the TAG also specifically requested the views of the PAG on the three options.

**Question 1: What are the PAG's views on the options proposed? Does the PAG agree that all of these options should be evaluated further, with a view to presenting them all in the Consultation Paper?**

### **3. Potential to use IFRS for SMEs as the basis for the Guidance**

- 3.1 Within the IFRS suite of standards, the IFRS for SMEs standard provides for simplified reporting requirements for for-profit organisations to meet the needs of smaller organisations. In 2019, work undertaken by the IFRS Foundation, found that 86 jurisdictions require or permit the IFRS for SMEs standard. The level of take up across jurisdictions suggest that the standard is meeting these needs.



## International Financial Reporting for Non Profit Organizations

- 3.2 As described on the IFRS website<sup>4</sup> – *“The IFRS for SMEs Standard is a self-contained Standard (fewer than 250 pages) designed to meet the needs and capabilities of small and medium-sized entities (SMEs), which are estimated to account for more than 95 per cent of all companies around the world.*

*Compared with full IFRS Standards (and many national GAAPs), the IFRS for SMEs Standard is less complex in a number of ways:*

- *Topics not relevant for SMEs are omitted; for example earnings per share, interim financial reporting and segment reporting.*
- *Many principles for recognising and measuring assets, liabilities, income and expenses in full IFRS Standards are simplified. For example, amortise goodwill; recognise all borrowing and development costs as expenses; cost model for associates and jointly-controlled entities; and undue cost or effort exemptions for specific requirements.*
- *Significantly fewer disclosures are required (roughly a 90 per cent reduction).*
- *The Standard has been written in clear, easily translatable language.*
- *To further reduce the burden for SMEs, revisions are expected to be limited to once every three years.*

*The SMEs Standard is available for any jurisdiction to adopt, whether or not it has adopted full IFRS Standards. Each jurisdiction must determine which entities should use the Standard. The Board's only restriction is that entities that have public accountability should not use it.”*

- 3.3 Whilst IFRS for SMEs is the only internationally developed standard for small and medium-sized organisations, it does not, for reasons outlined in the background content for this PAG meeting, meet all the needs of NPO entities, underlining the need for additional guidance for NPOs.
- 3.4 An additional factor that would need to be considered is that the IASB is currently developing plans to update IFRS for SMEs in order to reflect the impact of the major new standards it has issued in recent years (including Financial Instruments, Revenue and Leases), as well as to address issues that have arisen with its application in practice. These would need to be evaluated in more detail in order to understand both their potential impact on the appropriateness of IFRS for SMEs as a basis for NPO guidance, and whether the IASB's update timetable would support this.
- 3.5 The IPSAS suite of standards could be a potential start-point for the Guidance as they address non-exchange transactions and other transactions where the organisational motive is for social purposes rather than for profit. However, the IPSAS suite of standards does not yet have a standard for small and medium-sized organisations. Whilst it exists as a future project on the work program it is unlikely that there will be an IPSAS based standard within the next 5 years.

<sup>4</sup> Extracted from the IFRS website - <https://www.ifrs.org/supporting-implementation/supporting-materials-for-the-ifrs-for-smes/>



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- 3.6 Despite the potential issues outlined above, IFRS for SMEs is currently the only internationally developed standard currently available focused on small and medium sized entities. It is therefore proposed that IFRS for SMEs is evaluated in more detail for its potential to form the basis of the NPO Guidance. This is an area on which responses will be requested within the CP.

**Question 2: What are the PAG's views on the advantages and disadvantages of using IFRS for SMEs as the basis for the Guidance? What support does the PAG believe there is likely to be across the NPO sector for taking this approach?**

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