International Financial Reporting for Non Profit Organizations

Practitioner Advisory Group

AGENDA ITEM: PAGCP02-03
March 11, 2020 - online

Trio of projects

Summary	The paper sets out information about two additional project that are complementary with IFR4NPO, the 'Global Grant Community (Good Financial Grand Practice)' and 'Money Where it Counts'
Purpose/Objective of the paper	The purpose is for members to appreciate the linkages and complementarity with the IFR4NPO
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Actions for this meeting	**Note** the scope and objectives of the sister projects.

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International Financial Reporting
for Non Profit Organizations

Technical Advisory Group

Trio of projects

1. Background

1.1 The challenges relating to financial reporting experienced by not-for-profit sector stakeholders, (such as NPOs, funders and auditors), are diverse and inter-related.

1.2 NPOs may experience challenges with duplication of due diligence assessments from different funders, multiple donor reporting formats and audits, the difficulty of relating financial numbers to social impact, conflicts between the reporting requirements of regulators and donors, fraud, and inadequate contribution to their indirect costs.

1.3 Funders may also experience challenges with the cost and effectiveness of due diligence processes and audits, as well as difficulty in reconciling figures in the annual financial statements to the reports submitted to them. Even if they desire to contribute to indirect costs of their grantees, they may struggle to get assurance about what an organisation's applicable rate is.

1.4 Auditors carry out statutory organisational financial statement audits, or agreed-upon-procedures commissioned by funders. In countries lacking national guidance, they may struggle to interpret other international guidance, or have no applicable framework to quote in their audit opinion.

1.5 The objective of the IFR4NPO project is to develop internationally applicable financial reporting guidance for the preparation of an organisation's general purpose financial statements. While this will alleviate some of the problems, it will not, on its own solve all of the complex and inter-related issues mentioned above.

1.6 Two sister projects, namely the 'Good Financial Grant Practice' Standard, and the 'Money Where it Counts' initiative, aim to provide standardisation in the areas of due diligence and indirect costs. This paper sets out details about these two projects, and the interrelation with elements of the IFR4NPO project. The three projects together improve the possibility for addressing the broader range of financial reporting related pain points.

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2. About the 'Good Financial Grant Practice' Standard

2.1 The Global Grant Community was developed at the African Academy of Sciences in Nairobi, Kenya with support from some of the world's largest public and private sector funders including UKAID, Wellcome, UK Research and Innovation, the UK Dept. of Health & Social Care, the IKEA Foundation, the European & Developing Countries Clinical Trials Partnership (EDCTP), the African Union and the New Partnership for Africa's Development and Co-ordinating Agency (NEPAD).

2.2 The programme has three key outputs to date:

- New international standard for Good Financial Grant Practice (GFGP). This is a financial grant management quality standard.
- Portal based pre-certification scheme to the requirements of GFGP
- Global network of audit firms licensed to undertake site audits for certification that an organization's day to day operational activities are in compliance to the requirements of the GFGP standard

2.3 These three components are collectively called the Global Grant Community (GGC). The mission of the Global Grant Community is to use the disruptive power of technology to digitize, standardize and de-risk the due diligence process for both funders and grant receivers.

2.4 The Global Grant Community, after significant consultation, consistently adopts the language of 'grantors' and 'grantees', which this section of the paper follows.

2.5 The development of the GFGP standard was done in collaboration with many African grantees and international grantors. Technical advisors included Humentum (as Mango and InsideNGO), The British Standards Institute (BSI), The Chartered Institute of Management Accountants (CIMA) and a major accounting firm.

2.6 The GFGP standard itself consists of about 300 clauses of best practice across 4 areas related to grant management:

- **Financial management** (budgeting process, income and expenditure management, PPE, cash & bank, and inventory management, travel expenses, sub-grantees, financial systems, and financial reporting)
- **Human resources** (recruitment, payroll, timesheets, staff development, process for responding to allegations of corruption)
- **Procurement** (planning and contract management)
- **Governance** (policies, board, compliance, audit and risk)

2.7 The standard consists of four tiers with a view to catering to the different levels of sophistication required by organisations of different sizes and complexity. An organisation may choose which level they wish to be certified to.

- **Bronze:** Community Based Organisations, Civil Society Organisations, those with regional activities within a country

- **Silver:** Non-Governmental Organisations, those with activities across one or more countries
- **Gold:** Larger international non-governmental organisations, research institutes, continental / international activities, makes sub-awards.
- **Platinum:** Global INGOs or institutes, global activities

2.8 The standard was developed under the project management of British Standards Institute using a similar process for international quality standards. It was approved by the African Organisation for Standardisation (ARSO) in 2018.

2.9 Due to copyright protection, the standard can be downloaded from the National Standards Bodies e.g it can be purchased for $45 from the Kenyan Bureau of Standards.

2.10 Access to the portal containing the assessment questions based on the clauses in the GFGP Standard is available from www.gobalgrantcommunity.com at prices starting at $250 for one organisation accessing the bronze level only. The expectation is that potential funders would ordinarily pay for prospective grantees, as part of their costs of due diligence.

2.11 Within the online portal, there are four options for responding to each statement: Yes, No, In progress or N/A. There is also provision to write comments. Documents such as policies and procedures can be uploaded to a library and linked to a specific assessment question.

2.12 The clauses in the GFGP standard relate to procedures, processes and policies. Where clauses relate to accounting policies, they generally require organisations to have an accounting policy for a specific issue (eg income recognition) without stipulating what that policy should be.

2.13 The steps that a grantor and grantee follow may vary on a case by case basis, but the following is a typical example:

- The grantor and prospective grantee engage, and agree to undergo a due diligence process at the selected GFGP tier.
- The grantor purchases a subscription, and registers as a grantor on the online portal. The grantor then invites the grantee to register as a grantee on the online portal. (A grantee may also purchase a subscription and register themselves).
- The grantee completes a self-assessment of its own compliance against each requirement of the GFGP standard.
- When ready, the grantee gives the grantor access to their self-assessment.
- The grantor may choose to invest resources in validating the results with a site visit, agreeing on a plan to address gaps, and supporting capacity building needs.
- When the grantee considers themselves to be compliant, they can be assesed by a GGC accredited auditor, and achieve certification. The cost of certification assurance may be financed by the grantor or the grantee.

2.14 Subject to a grantee's permission, other grantors can have visibility of the grantee's responses within the portal, together with their certification status. Thus, achieving certification makes grantees more attractive to potential grantors, and the due diligence process does not need to be duplicated.

2.15 To date there are about 231 organisations registered on the portal.

3. Abut the 'Money Where it Counts' initiative

3.1 'Money where is counts' is a protocol for donor-harmonised cost classification and financial budgeting and reporting.

3.2 The protocol was presented at an event in Brussels on 25 September 2019 by the Norwegian Refugee Council (NRC) and Humentum, with the engagementof the European Union Civil Protection and Humanitarian Aid (ECHO) and the Voluntary Organisations in Cooperation in Emergencies (VOICE) Network.

3.3 The protocol presented at the event is the result of four years of work by NRC, initially in collaboration with the Boston Consulting Group and subsequently in partnership with Humentum.

3.4 The design of the protocol was led by Humentum acting as an independent broker of an agreement among nine organisations (NRC, ACF Spain, CARE, DRC, Humanity and Inclusion, Oxfam GB, Save the Children International, Save the Children UK, and Welthungerhilfe). The protocol has been so far endorsed by six of the nine participating organisations, while the rest continue to assess the changes which might be needed in their organisations to enable them to endorse the protocol.

3.5 Each participating organisation's cost structure and cost charging methodology were analysed to design a practical solution for harmonisation, which required compromises for every participating NGO and is applicable well beyond the initial group.

3.6 The MWIC protocol consistently adopts the language of 'donors' and 'agencies', which this section of the paper follows.

3.7 The benefits that the protocol aims to bring include greater efficiency in the production and use of donor financial reports, meeting the commitments of the Grand Bargain arising from the Humanitarian Summit 2015, and ultimately more resources to programmes.

3.8 The premise of the protocol is a series of trade-offs and benefits for donors and agencies, with commitments from both sides summarised below:

Donors give	Donors get / Agencies give	Agencies get
Commit to paying full reasonable and justifiable costs relating to the activities they fund	Transparent and consistent budgets and financial reports	Fully funded projects: reasonable and justifiable direct and indirect costs
Accept harmonised budgets and reports in MWIC format and indirect costs based on audited accounts	Demonstrated financial vigilance and cost control with detailed reports prepared when necessary	Simplified and harmonised approach adopted by funders
Accept cost pooling and apportionment for certain direct costs	Clear and consistent cost charging mechanisms justified with rationale and supported by a third- party evidence base	Opportunity to streamline and automate processes
More resources to programmes and beneficiaries		

3.9 The MWIC protocol contains four sections, which are explained further in following paragraphs:

- Definitions of types of cost
- Description of allowable cost charging methods
- Harmonised budget and financial report format
- Cost classification and cost charging statement

3.10 The protocol also contains a set of clear principles underpinning its design, and concrete commitments by all donors and agencies which sign up to it. It is currently drafted as applicable to agencies working internationally. There is a footnote in the protocol about the intent to create a version for local/national agencies without international operations.

3.11 The MWIC protocol provides agreed definitions for direct costs, indirect costs and illegible costs.

- Direct costs: The costs of all necessary and reasonable inputs associated with functions which are directly necessary to deliver a programme or project:
  - Project and grant management, technical delivery, quality control functions, visibility and communications
  - Human resources and security
  - Compliance
  - Finance, procurement, payroll, information technology and administration

- Indirect costs: the costs of all necessary and reasonable inputs associated with functions which are necessary to manage the agency as a whole, provide oversight over all its activities and put into place the overarching policies, frameworks and systems that enable it to operate. It is not practicable to relate indirect costs to individual funding arrangements directly, but without the functions they represent, programmes and projects could not be delivered effectively, efficiently, on time, and safely

- Ineligible costs are limited to:
  - Losses or provision for losses due to fraud and corruption
  - Purchase of land and buildings (unless explicitly agreed in the funding arrangement)
  - Interest/debt servicing costs (unless the funds are paid in arrears)
  - Disallowed costs from activities funded through funding arrangements (when the protocol is fully implemented)
  - Costs of raising unrestricted or unearmarked funds
  - Costs of gifts and donations
  - Alcohol costs
  - Entertainment costs

3.12 Under the MWIC protocol, an agency may charge direct costs to a project in any of the following ways, which are clearly defined with examples in the protocol:

- 100% charge of a direct cost
- Allocation of a direct cost based on actual use
- Apportionment of the costs associated with a pooled direct resource (for example the costs of running a regional office which supports a number of projects)

The basis for charging allocated and pooled direct costs is transparently explained in a standard format 'Cost Classification and Charging Statement.'

3.13 Under the MWIC protocol, an agency may charge indirect costs, calculated as a percentage (the indirect cost rate) of direct costs. The indirect cost rate for each agency is calculated with reference to their last audited financial statements in accordance with the format shown in Appendix A. The formula for the indirect cost rate is:

$$\text{Indirect rate} = \frac{\text{indirect costs}}{\text{direct costs + ineligible costs}}$$

3.14 The MWIC Protocol adopts a single format for budgets and reports, as set out in Appendix B. In section A, direct costs are classified by nature into the following categories below. Donors may request a detailed breakdown of the figures if required, which the agency will submit in its own reporting format, reconciled to the cost heading in the standard report):

- Staff costs
- Travel and subsistence
- Capital expenditure
- Downstream partners
- Supplies, materials and cash transfers to beneficiaries
- Running costs, external services to the project and other costs

3.15 In section B of the budget and financial format, total project costs are apportioned to outcomes and results using an indicative method which can be applied "off-system".

3.16 Other optional annexes may also be requested.

3.17 The MWIC protocol is ready to be piloted with a number of donors and agencies for further refinement and proof of concept prior to increased adoption by a wider range of donors.

3.18 The full MWIC Protocol can be accessed here: https://files.humentum.org/fl/T66AWs9Yf5

4. Inter-linkage between GFGP, MWIC and IFR4NPO Projects

	GFGP	MWIC	IFR4NPO
Primary objectives	Improved due diligence processes Improved grant management practice	Harmonised and more efficient project-based budgeting and donor reporting Full costs of projects funded	Consistent and meaningful organisation-wide general purpose financial reports

4.1 The GFGP standard relates primarily to procedures, processes and policies relating to grant management, but nineteen of the statements relate to accounting policies or organisation wide financial statements. For example, organisations are required to state their accounting policies on: gifts-in-kind, definition of asset and inventory, valuation of inventory, asset impairment, income recognition, sub-grantee expenses recognition and consolidation, foreign currency gains and losses, and treatment of unspent income at the end of the period.

4.2 The GFGP standard has such a strong focus on disclosure of such policies, precisely because there is a great deal of variety and lack of transparency around the treatment of those issues. The IFR4NPO project does not conflict with this in any way, rather it simplifies the process for organisations by providing international guidance for what the appropriate accounting policies should be.

4.3 In a few instances, the GFGP standard stipulates a particular accounting policy or alternatives (with respect to asset impairment and recognition of sub-awardee expenses). In those cases, it will be important to acknowledge any potential conflict between the requirements of the GFGP standard and the guidance issued by the IFR4NPO project at an early stage, and ensure alignment to avoid a confusing situation where compliance with the IFR4NPO guidance requires non-compliance with GFGP.

4.4 One statement in the GFGP standard requires organisations to 'have a financial system that enables them to produce financial statements in accordance with GAAP', presumably referring to the national GAAP in whichever jurisdiction they operate. Once the IFR4NPO guidance is issued, it is conceivable that it could be carefully refenced in this requirement, so that GFGP certification could also encourage adoption of the IFR4PO guidance.

4.5 The MWIC protocol describes various aspects of expenditure classification, by type (direct, indirect, ineligible), headings for categorisation by nature (staff costs, travel costs etc) and by function (in section B of the budget and report format). Classification of expenses is also an issue being discussed by the IFR4NPO project. It would be appropriate to ensure a level of consistency between the two that at least enables use of a single chart of accounts for both purposes.

4.6 The MWIC protocol refers to the audited financial statements for transparent calculation of the indirect cost rate. The IFR4NPO project might consider the merits of the MWIC approach and whether disclosure of that rate in the financial statements would be appropriate.

4.7 These three initiatives share common ground. They are all relevant to funder, NPOs and auditors. They all aim to harmonise practice across different organisations and jurisdictions. They all aim to raise the bar in terms of quality by aligning to a standard that represents good practice. They all acknowledge that the biggest losers from the current fragmentation in global approaches is the smaller, less powerful organisations, which ultimately diminishes the impact they are able to achieve.

4.8 The MWIC protocol is at a draft stage, ready for piloting. The GFGP standard is issued but will likely go through its first revision within the time frame of the IFR4NPO project. It is important that the funders, NPOs and auditors interacting with these three harmonised approaches sense that they are coherent, complementary and consistent.

Question 1: What are the TAG's views on the combined power of these three projects? What is the best way to harness this power?

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Appendix A – MWIC Protocol Indirect cost calculation

Money Where It Counts

Indirect Cost Analysis

Name of agency:	
Financial reporting year:	
Approved by (FD or equivalent):	
Date approved:	
Verified by (name, position, company):	

	Assigned to[3]			
Cost unit[1]	Direct costs	Indirect costs	Ineligible costs	Total costs
LIST OUT COST UNITS HERE				
				-
				-
				-
				-
				-
ADD ROWS IF NECESSARY				-
				-
Total costs	-	-	-	-
Adjustments[2]				
LIST OUT ANY ADJUSTMENTS MADE				
1				-
2				-
Adjusted total costs	-	-	-	-

Indirect cost rate	#DIV/0!

	Confirm
The unadjusted total cost agrees to the total costs in the published accounts for this financial year	Y/N

Adjustments: please provide an explanation for every adjustment applied to the total costs in calculating the annual indirect cost rate

Explanations:

1
2

Appendix B – MWIC Protocol Financial report format

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Money Where It Counts

Financial budgeting and reporting template

Donor:		Country of operation:		Funding date from:		% funded by this donor[2]	0%
Donor code[1]		Project code (if applicable)		Funding date to:		Total pooled costs[3]	
Funding arrangement code[1]		Currency of report		Reporting date (if applicable):		of which covered here[4]	0%

	Cumulative expenditure	Total budget	Variance	Variance as % of Total costs
Directly charged costs	**0**	**0**	**0**	**0.0 %**
Staff costs		0	0	0.0 %
Travel and subsistence		0	0	0.0 %
Capital expenditure		0	0	0.0 %
Downstream partners		0	0	0.0 %
Supplies, materials and cash transfers to beneficiaries		0	0	0.0 %
Running costs, external services to the project and other costs		0	0	0.0 %
Direct pooled costs - share[5]		**0**	**0**	**0.0 %**
Total direct costs	**-**	**-**	**-**	**0.0%**
Indirect costs[6]	-	-	-	**0.0 %**
Total costs	**-**	**-**	**-**	**0.0%**
Financing of costs				
Cost funded by donor		0	0	0.0%
Cost funded by other sources (including unrestricted funds)	0	0	0	0.0%

Financial report narrative, including key explanations:

This report complies with the conventions under the Money Where It Counts Protocol

Name and position		**Date:**	
Signed:			

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