



Technical Advisory Group

AGENDA ITEM: TAGCP01-3

October 3-4, 2019 - London, United Kingdom

Project Objectives

Summary	This paper builds on the project background paper (Paper 2) to set out the proposed objectives for the project.
Purpose/Objective of the paper	There are high expectations about the output from this project. The objectives of the project need to be clear, specifically in terms of which parts of the not-for profit sector should expect to benefit from the Guidance, who else should expect to benefit from the project and any other considerations including measurements of success.
Other supporting items	TAGCP01-2 Background to IFR4NPO Project
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Actions for this meeting	Comment on: <ul style="list-style-type: none">• The proposed project objectives• Specific input required from the PAG
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Project Objectives

1. Need for specific internationally applicable financial reporting guidance for NPOs

- 1.1 In order to set both the boundaries for the project and to be able to measure its success, it is important that there are clear objectives for the work of the TAG. These objectives need to reflect the expectations of the donors who have provided the seed funding for the project, technical considerations and the needs of the not-for-profit community.
- 1.2 Not-for-profit organisations (NPOs) increasingly operate internationally and/or locally across borders. This requires international NPOs to register and report in different countries that have different financial reporting requirements. As there is no international accounting standard for NPOs, reporting formats vary widely, and the same transactions can be treated differently in different countries.
- 1.3 Few countries have bespoke standards or guidance for NPOs. Therefore, financial statements have been prepared using accounting standards developed for the private or public sectors and which do not generally address those issues and concepts specific to the not-for-profit sector.
- 1.4 Alongside this position, private donors and international funders are increasingly taking a global approach to their work. As a result charities and non-government organisations currently face a multiplicity of international grant regimes which require financial information to be prepared under different accounting and financial reporting standards.
- 1.5 NPO funders need to use and interpret grantee financial reports that have been prepared under these different reporting requirements. This undermines the ease and reliability of due diligence, and also makes it harder to compare performance between grantees. Therefore funders often impose their own financial reporting requirements, creating further complexity and duplication of work for NPOs.



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- 1.6 In 2013, 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. The 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.
- 1.7 The report also identified a number of key differences between NPOs and private sector bodies, and to a lesser extent those in the public sector, and supported the need for separate international guidance for NPOs. These issues are considered further in Paper 7 (Potential Consultation Paper Issues)
- 1.8 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 pressures on respective agendas and that developing such standards is not within the remit of either body.

Question 1: Does the TAG agree that specific internationally-applicable guidance is required for NPOs, and that this should address the issues that are common across the NPO sector, in order to maximise its applicability?

2. Approach to defining Guidance applicability

- 2.1 Although the Guidance will be non-mandatory, understanding which organisations are NPOs and therefore who the Guidance developed through the IFR4NPO project should be applicable to is an important question. This is one of the issues that has come to the fore through a number of avenues and is included as one of the long list issues in Paper 7.
- 2.2 In the 2014 CCAB Report¹, the definition of NPOs was reported as an issue by survey respondents. The report described a number of terms to describe not-for-profit entities; NPOs, non-government organisations (NGOs), charities, public benefit entities, voluntary organisations, donee organisations, membership organisations, professional associations, societies, mutual and non-investor-owned social enterprises. The report noted that some of these entities allow for the distribution of profits and therefore may not strictly be NPOs. Importantly it notes that these terms can have different meanings in different jurisdictions and to that contained in law.
- 2.3 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.
- 2.4 Definitional issues are not unique to NPOs. IPSASB faced the same challenge with defining the public sector. In this case, after much debate and public consultation, IPSASB concluded that the final decision on whether and how

¹ International financial reporting for the not-for-profit sector – A study commissioned by CCAB published February 2014.



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IPSAS should be applied to a particular entity or types of entity will be taken at jurisdiction level. Therefore as it could not mandate the application of its standards, IPSASB decided it should instead describe the nature of the entities for which it was developing standards in order to inform the decision at jurisdiction level. The Preface to the IPSASB Handbook therefore sets out the scope of the Standards in a narrative form to give guidance as to the entities expected to be covered by the Standards. Paragraph 10 says:

'The IPSAS are designed to apply to public sector entities² that meet all of the following criteria:

- a) Are responsible for the delivery of services³ 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.*

- 2.5 In the context of the IFR4NPOs project, some idea of the nature of the NPOs the Guidance is intended for is essential, because in considering the accounting issues, the potential application in practice needs to be considered. However, the breadth of the sector and differences within and between jurisdictions means that it is unlikely that a single definition will accommodate the range of organisations that might be expected to fall within the scope of the Guidance. As with the approach taken by IPSASB, a narrative set of descriptions that go to the purpose and objectives of the organisation is therefore proposed.

Question 2: Does the TAG agree that the Guidance applicability needs to be communicated, and that this should be done through a narrative descriptions approach?

3. Intended Primary User Groups

- 3.1 The current absence of internationally applicable guidance has resulted in NPOs preparing financial information that is inconsistent and unable to be compared between jurisdictions, or sometimes even within them.
- 3.2 As a consequence, the funding community require financial reports to be prepared using standards and frameworks that are often specific to their own organisation or domicile. This approach contributes to the overall complexity of funder requirements that are costly to administer. Recipient organisations currently waste considerable time and resource meeting different funders' reporting requirements. Funders also struggle to carry out effective due diligence as the staff responsible cannot effectively interpret the wide variety of audited accounts they have to review sufficiently well to make judgements about the potential grantee's financial capabilities and situation.

² 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.

³ Services encompasses goods, services and policy advice, including to other public sector entities.



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- 3.3 This project can play a key role in strengthening the accountability of NPOs internationally. Whilst the sector recognises the need to be more accountable, doing so requires appropriate and reliable standards.
- 3.4 The development of the Guidance will create the basis for more consistent and higher quality financial reporting in the not-for-profit sector. It will reduce confusion and set a clear benchmark of what good financial reporting looks like. By helping to improve the standard of financial reporting, the Guidance will also support stronger financial management within NPOs.
- 3.5 The Guidance will also support greater harmonisation of funders' requirements by introducing approaches to accounting which are internationally recognised. This has the potential to simplify the reporting process, therefore saving time and administrative costs for funders and NPOs.
- 3.6 Greater consistency in reporting will also 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.
- 3.7 The Guidance will also satisfy the demand amongst 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. 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 resources available to develop this.

Question 3: Does the TAG agree that in addition to preparers, the intended primary Guidance user groups should be funders and national standard setters? Are there other user groups that should be considered?

4. Overall Project Approach

- 4.1 Rather than attempting to address the reporting needs of all sizes of NPOs, it is proposed to take a staged approach with guidance developed for organisations of different sizes and complexities in different stages.
- 4.2 The NPO sector is typically composed of many different types and sizes of organisations, with many smaller organisations operating on a strictly local basis. Given the nature of the intended primary user groups, it is proposed that the first set of guidance should be aimed at small and medium sized NPOs. This would mean that in subsequent stages, guidance could be developed for the very largest and smallest NPOs.

Question 4: Does the TAG agree that the initial Guidance should be aimed at the needs of small and medium sized NPOs?



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5. Guidance Basis

- 5.1 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. Instead it is proposed that the Guidance should sit alongside an existing international reporting framework, in order to use its hierarchy, structure and legitimacy in order to minimise the development time.
- 5.2 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 2017, work undertaken by the IFRS Foundation, found that 85 jurisdictions require or permit the IFRS for SMEs standard. The level of take up across jurisdictions suggest that it is meeting these needs.
- 5.3 As described on the IFRS website⁴ – *“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.”

- 5.4 The IPSAS suite of standards does not yet have a standard for small and medium-sized organisations. Whilst it is on the future work program it is unlikely that there will be an IPSAS based standard within the next 5 years. The IPSAS standards do, however, address non-exchange transactions and other transactions where the organisational motive is for social purposes rather than for profit.

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



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- 5.5 IFRS for SMEs is therefore the only internationally developed standard currently available. It is therefore proposed that IFRS for SMEs forms the basis of the NPO Guidance.
- 5.6 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 TAG meeting, meet all the needs of NPO entities, underlining the need for additional guidance for NPOs.

Question 5: Does the TAG agree that the Guidance should sit alongside IFRS for SMEs?

6. Guidance Scope

- 6.1 International and national accounting standards generally focus on General Purpose Financial Statements (GPFS), where GPFS are developed to address the common information needs of a wide range of users, especially those who are not in a position to demand information directly from an organisation. The objective of such financial statements being to provide information about the financial position, performance and cash flows.
- 6.2 With a diverse range of stakeholders having an interest in the financial management of NPOs, narrative reporting has been raised as an area where there could be improved guidance. Narrative reporting can support the accountability, transparency and stewardship objectives of financial reporting. However, narrative reporting does not fall within GPFS, and is not covered in IFRS for SMEs. Instead Narrative reporting requirements have generally been set through other mechanisms including local legislation, and non-mandatory guidance, allowing jurisdictional flexibility.
- 6.3 As narrative reporting is not addressed by IFRS for SMEs, developing narrative reporting guidance from scratch would be a major project scope extension. Instead it is proposed that the project should consider the applicability of IFRS Practice Statement 1, and the likely revisions to this, in order to determine whether additional guidance is required for NPOs.

Question 6: Does that TAG agree that the narrative reporting in IFRS Practice Statement 1 should be considered when determining whether additional guidance is required for NPOs?

7. Stakeholder engagement

- 7.1 Stakeholder engagement will be vital in order to ensure the Guidance meets the needs of the primary user groups, and is taken up as widely as possible. This will be considered in more detail under Item 11.
- 7.2 The Practitioner Advisory Group (PAG) will be a critical component of the stakeholder engagement process. PAG members are expected to be drawn from geographically diverse and sector (e.g. preparer, user, donor, audit, regulatory) diverse communities. The PAG may therefore bring different perspectives concerning the objectives of the project, which will be important as part of overall engagement and ensuring that the objectives are



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appropriate. The project objectives will be tabled for discussion at the first PAG meeting in December. As these objectives will frame the work content of the project it is important that the TAG understands additional perspectives that may be provided by the PAG.

- 7.3 In providing guidance to support the preparation of GPFS, the Guidance will also inform the work of auditors in reaching opinions on financial statements. In executing the project there will need to be engagement with the audit community as to how it will use the Guidance to fit with the overall objectives of the project. The PAG is intended to include membership from the international audit firms involved in NPO audit work, but other mechanisms will also need to be considered.
- 7.4 There are also other initiatives in train internationally focused on aspects of financial management that will need to be considered in developing the Guidance. The Good Financial Grant Practice (GFGP) Standard has recently been developed by the African Research and Standards Organisation to provide a harmonised and standardised process for due diligence in grant-making. This is a quality standard that aims to become a global ISO standard. The implementation of the GFGP will be greatly assisted by greater harmonisation of accounting treatments. Similarly work taking place as part of commitments under the Grand Bargain⁵ to harmonise the project budgeting and reporting requirements of humanitarian donors, will benefit from harmonisation of accounting treatments.

Question 7: What specific input should be sought from the PAG on the proposed project objectives?

8. Proposed Project Objectives

- 8.1 In seeking funding for this project, the overall goal was described as:

Develop a robust financial reporting framework for NPO general purpose financial statements, with sufficient engagement and consultation with relevant stakeholders.

- 8.2 To put this goal into context the mission/objectives of the IASB and IPSASB are as follows:

"Our mission is to develop standards that bring transparency, accountability and efficiency to financial markets around the world. Our work serves the public interest by fostering trust, growth and long-term financial stability in the global economy." (IFRS website)

"to serve the public interest by developing high quality accounting standards and other publications for use by public sector entities around the world in preparation of general purpose financial reports " (IPSASB Preface to International Public Sector Accounting Standards)

⁵ The Grand Bargain on efficiency and effectiveness was agreed by many nation states and the world's largest humanitarian donors at the World Humanitarian Summit in 2015.



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- 8.3 Success for this project was described as:
- audited financial statements based on the guidance being accepted as best practice by most major international donors; and
 - audited financial statements based on the guidance are accepted by most major international donors, rather than requesting specific project audits.
- 8.4 Taking account of these factors, it is proposed that the TAG adopts the six objectives below for the project. Objectives 1 to 5 relate to the nature of the outputs from this project. Objective 6 relates to the way in which stakeholders will be engaged to maximise Guidance take-up. These objectives will then frame the TAG's future work. The issues involved are considered further in TAGCP01 -04 Terms of Reference, TAGCP01 – 05 Nature of the Guidance, TAGCP01 – 06 Approach to Consultation Paper Development and TAGCP01 – 07 Potential Issues.

Objective 1: To provide internationally applicable non-mandatory Guidance for NPOs, that addresses the issues that are common across the NPO sector, in order to maximise its applicability.

Objective 2: To communicate the potential applicability of the Guidance through a narrative descriptions approach.

Objective 3: To deliver guidance that meets the general financial reporting requirements of funders and national standard setters, in addition to preparers.

Objective 4: To provide initial Guidance aimed at the needs of small and medium sized NPOs, sitting alongside IFRS for SMEs.

Objective 5: To consider narrative reporting in IFRS Practice Statement 1 to determine whether additional guidance is required for NPOs.

Objective 6: To facilitate the adoption of the Guidance through wide stakeholder engagement that best ensures that the Guidance is relevant to and meets the needs of donors, NPOs and other key users of NPO audited accounts throughout the world.

Question 8: Does the TAG believe that there are other objectives that need to be considered?