

Technical Advisory Group Issue Paper

AGENDA ITEM: TAGCP08a-02

19 May 2020 – Online

Narrative Reporting

Summary	Narrative reporting has been identified as a specific issue for non-profit organisations. This paper brings together material gathered from national and international standard setters.
Purpose/Objective of the paper	To allow TAG members to consider the nature of the issue, potential ways forward and text for inclusion in the Consultation Paper.
Other supporting items	None
Prepared by	David Loweth
Actions for this meeting	<p>Advise on:</p> <ul style="list-style-type: none"> • The description of the issue • The list of alternatives to address the issue • Links to other international standard development, national standards or other guidance • The need for any further input.

Narrative Reporting

Part 1 – Advice Sought

1. Consultation Paper Draft

- 1.1 At the TAG meeting on November 4 2019, the TAG agreed that narrative reporting should be included in the short list of issues to be included in the Consultation Paper.
- 1.2 Part 2 of this paper has been drafted for discussion, with the aim that the text is capable of being inserted directly into the Consultation Paper, subject to any drafting comments. There are challenges in finalising the drafting of this topic paper, given the interplay with Part 1, which is being revised following TAG input.

#	Question
1	What comments does the TAG have on Sections 1 and 2?
2	Do the summaries of national-level and international guidance in Sections 3 and 4, together with Annex A, accurately reflect the current standards/ guidance? Is the TAG aware of any other guidance on narrative reporting issued by national standard setters or other regulatory bodies that should be included in the Consultation Paper?
3	Does the TAG agree with the presentation of the key issues in section 5, which link to other topics for inclusion in the Consultation Paper?
4	What comments does the TAG have on the proposed SMCs in relation to this topic and are there other specific SMCs that could be raised?

2. Next steps

- 2.1 The text drafted below will be included in the Consultation Paper subject to any further comments from the TAG. The Practitioner Advisory Group will be consulted on any specific issues raised by the TAG further to this discussion.

#	Question
5	Is there specific input to be sought from the PAG?

May 2020

Narrative Reporting

Part 2 - Draft Consultation Paper Text

1. Description of the issue

- 1.1 There has for decades been a recognition that financial statements, while being important, do not meet all the information needs of users and that there is a need for the provision of other information giving details of, for example, an entity's performance and prospects. For example, in 1978 the European Union introduced a requirement that the reporting package of financial information consists of financial statements and the annual report, and that the latter "...must include at least a fair review of the development of the company's business and of its position".
- 1.2 The importance of such other, narrative, information is as relevant, if not more so, for NPOs, in particular for demonstrating accountability and stewardship to stakeholders and civil society. For many NPOs, the financial statements do not capture many of the most important aspects of an organization's performance, which can focus more on non-financial issues and measures. Examples of such aspects could include the use and importance of volunteer contributions and the impact of an organization on the communities and beneficiaries it seeks to serve.
- 1.3 For NPOs there can also be a lack of clarity on the reporting of remuneration, governance arrangements and the effectiveness of the NPO with a focus on making maximum use of resources received. As noted in the Chapter on Fundraising Costs, this can be addressed through the publication of ratios that are intended to demonstrate the relationship between fundraising and service delivery costs.
- 1.4 Disclosure requirements currently vary across jurisdictions, dependent on local accounting requirements, local regulation and local legislation. This can make it challenging for stakeholders where an NPO's General Purpose Financial Reports (GPFRs) are used in multiple jurisdictions or where a stakeholder is using GPFRs from similar NPOs that operate in different jurisdictions.

2. Financial reporting challenges

- 2.1 Narrative reporting has become a "growth industry" in recent years, with the proliferation of multiple frameworks, codes, standards and guidelines on a wide range of reporting issues, many in the broad area of sustainability (also referred to as corporate responsibility, corporate social responsibility (CSR), and environmental, social and governance (ESG) reporting). There is also an increasing focus on reporting on climate-related issues. An initial challenge would be to determine which of the

multiple frameworks, codes, standards and guidelines would be the most appropriate basis on which to develop proposals for narrative reporting by NPOs.

- 2.2 There is also an issue as to the extent to which any proposals for narrative reporting by NPOs should be pitched at a “framework” level, articulating broad principles and content elements to be included, rather than any other more specific items and/or measures to be included. For example, the issues of the costs of fundraising and the classification of expenses by function or nature (discussed as separate issues) and, in particular, whether disclosures relating to such costs and their categorisation (including ratio analysis of such costs) could form part of the notes to the financial statements or part of narrative reporting. It should be noted that disclosures as part of the accounts of the financial statements are subject to audit.
- 2.3 Narrative reporting is usually prepared from the perspective of the management of an organization, hence its description using terms such as “management commentary” (see paragraph 3.1). Narrative reporting provides an opportunity for management to provide to stakeholders its perspective of the organization’s performance, position and progress, including information that is useful to an understanding of:
 - (a) the nature of the organization’s business;
 - (b) management’s objectives and its strategies for meeting those objectives;
 - (c) the organization’s most significant resources, risks and relationships;
 - (d) the results of operations and prospects (including information that both complements and supplements the financial statements, as well as providing forward-looking information); and
 - (e) the key performance measures and indicators that management uses to evaluate the organization’s performance against stated objectives.
- 2.4 The general principles and content elements of narrative reporting could be applicable to all organizations, although the appropriate level of detail in reporting could differ depending on factors such as an organization’s size, complexity and resources. The flexibility of a principles based approach is relevant to consider in the context of the calls that have been made for NPO narrative reporting to address such matters as the remuneration of key management personnel and related party disclosures.
- 2.5 A framework approach demands more judgement from management than a more prescriptive approach and there can be a risk that, faced with interpretative uncertainty, management will err on the side of caution and disclose larger quantities of data rather than exercising the judgement required to present the information to meet stakeholders’ needs. This may generate confusion, rather than transparency if reports become overly complex. Also, requirements in local jurisdictions could add to or be inconsistent with disclosures arising from a framework type approach.

- 2.6 Some aspects of narrative reporting can involve more uncertainty than the historical information presented in the financial statements, which will present another financial reporting challenge. This is the case, for example, in the provision of forward-looking information, where it could be appropriate for management to explain any material assumptions in the preparation and disclosure of such information. There will also be challenges in the inclusion of non-financial measures and indicators, where management will have to explain how these measures and indicators are defined and calculated. There will also be a challenge in management reporting in a balanced way, dealing even-handedly with both good and bad aspects of the performance, progress and prospects of the organization.
- 2.7 Much of the narrative reporting that currently takes place at both international and national level is within an organization's annual report, but outside the financial statements. As a consequence, such reporting falls outside the scope of a formal opinion by the auditors on the financial statements, although there will often be a requirement on the auditors (for example, as in International Standard on Auditing (ISA) 720 (Revised) *The Auditor's Responsibility Relating to Other Information*) to read such information to identify any material inconsistencies between that other information and (a) the financial statements and (b) the auditors' knowledge obtained in the audit. This is a level of assurance significantly less than that of a formal audit.

3. Current international guidance

- 3.1 International Financial Reporting Standards (IFRS) do not address the issue of narrative reporting within the Standards themselves, but the International Accounting Standards Board (IASB) in 2010 issued a non-mandatory Practice Statement Management Commentary, which does cover the issue. The IASB is in the process of reviewing and revising the Practice Statement, with an Exposure Draft (ED) scheduled for release during 2020.
- 3.2 IFRS for SMEs doesn't specifically include narrative reporting, although the non-mandatory practice statement is available for use.
- 3.3 Likewise the International Public Sector Accounting Standards (IPSAS) do not specifically address this issue within the Standards themselves. The International Public Sector Accounting Standards Board (IPSASB) also issued non-mandatory material in the form of Recommended Practice Guidelines (RPGs) to address the issue, as follows:
- a) RPG 2 Financial Statement Discussion and Analysis (2013), which covers some, but not all, the issues covered in the IASB's Practice Statement referred to above, focussing on

an explanation of the significant items, transactions and events presented in an entity's financial statements and the factors that influenced them; and

- b) RPG 3 Reporting Service Performance Information (2015), which focuses more on how an entity should report on its effectiveness, efficiency, inputs, outputs and outcomes, together with its performance indicators and service performance objectives.
- 3.4 Both the IFRS Practice Statement and IPSAS RPGs adopt a framework approach based on principles, giving entities flexibility on how to apply them relevant to their own circumstances, rather than set out very specific individual recommendations.
 - 3.5 Both the IASB and IPSASB have standards on related party disclosures (IAS 24 Related Party Disclosures and IPSAS 20 Related Party Disclosures) which focus on the disclosure of remuneration (including salaries and other benefits such as pensions) of key management personnel and related party disclosures. IFRS for SMEs requires related party disclosures consistent with IAS 24.
 - 3.6 Outside of the IASB and IPSASB guidance, one other major relevant development (of many, as noted above) in recent years has been the growth of Integrated Reporting (IR), in particular the International Integrated Reporting Framework developed by the International Integrated Reporting Council (IIRC).
 - 3.7 The IIRC Framework provides a non-mandatory, principles-based reference for organizations wishing to adopt IR. The primary purpose of an integrated report is to explain to providers of financial capital (and other stakeholders) how an organization creates value over time. An integrated report aims to provide insight about the resources and relationships used and affected by an organization (referred to as capitals in the Framework, covering financial, manufactured, intellectual, human, social relationship, and natural capital). The Framework approach enables an organization to set out its report in its own way rather than adopt a checklist approach. In February 2020, the IIRC launched a process to revise the Framework.
 - 3.8 While developed for the for-profit sector, IR could be relevant for NPOs to demonstrate how they seek to optimize their use of available resources and report on operations to their stakeholders.

4. National-level guidance

- 4.1 There are differences between jurisdictions as the requirements and/or guidance for narrative reporting by NPOs. We are unaware of any jurisdiction that has a separate standard or standards governing narrative reporting by NPOs.

- 4.2 One jurisdiction provides guidance on narrative reporting within its overall requirements for accounting and reporting by NPOs. In that jurisdiction, a Statement of Recommended Practice (SORP) sets out not only requirements for the preparation of financial statements, but also the content of the annual report prepared by the management body (the trustees in this instance), including the context for, and a narrative explanation of, the financial information contained in the accounts. There are differential narrative reporting requirements, given the greater degree of accountability to civil society and stewardship reporting required of larger NPOs. Those requirements share much in common with the jurisdictional requirements for narrative reporting by corporate entities, which in turn share much in common with the IASB's *Management Commentary* Practice Statement.
- 4.3 Another jurisdiction has a specific standard that sets out requirements for its Public Benefit Entities (NPOs) in their reporting of service performance information. The standard takes into account the extent to which the recommendations in IPSASB's RPG 3 are appropriate in the jurisdictional context. As with the jurisdiction referred to in paragraph 4.2 above, the standard contains differential reporting requirements. The standard also establishes principles and high-level requirements for the reporting of service performance information rather than specifying detailed reporting requirements.
- 4.4 A number of other jurisdictions, whilst having no general guidance covering narrative reporting by NPOs as part of their annual reports, do have specific requirements to lodge annual information with their relevant regulatory body. However, such annual returns are generally focused on meeting the information needs of a regulatory body, rather than forming part of General Purpose Financial Reporting (GPFR).

5. Alternative financial reporting treatments

- 5.1 Given the importance of narrative reporting in the NPO context, and the fact that there is existing guidance at both international and jurisdictional level, it could be beneficial to incorporate the development of global narrative reporting guidance as part of the IFR4NPO initiative.
- 5.2 The scope of this project and whether it should include narrative reporting is considered in Part 1 to this document. Alternative 1, which proposes the continued use of existing guidance relevant in each jurisdiction, would be the default option if feedback from respondents proposes that narrative reporting is not included within the scope of the project. This would allow individual jurisdictions and/or organizations to continue to develop their own policies and guidance on narrative reporting.
- 5.3 Alternative 2 proposes additional guidance for NPO's consistent with the recommendations of the IASB and IPSASB, but with specific NPO examples. In this

alternative, applying the principles outlined in the additional guidance could be required for all GPFs.

- 5.4 Alternative 3 proposes to move ahead of current international accounting guidance and move to the International Integrated Reporting Council framework. This could be tailored for NPOs and enable a comprehensive view of an organisation's resources and relationships and how it has used these and plans to use them over time. In tailoring for NPOs, this would focus on the needs of NPO stakeholder groups.

	Description	Advantages	Disadvantages
Alternative 1 ‘Do nothing’ Leave organizations/ jurisdictions to follow existing guidance on narrative reporting by NPOs.	<ul style="list-style-type: none"> Organisations are left to follow any existing guidance or requirements in their own jurisdictions, or to voluntarily apply any existing international guidance. 	Technical <ul style="list-style-type: none"> Meets the requirements/ recommended practice of IFRS and IPSAS. Practical <ul style="list-style-type: none"> No change on the current position so easy to implement. Cost/benefit <ul style="list-style-type: none"> Minimises burdens on NPOs. 	Practical <ul style="list-style-type: none"> Missed opportunity to develop global best practice on what “good” narrative reporting should cover. Stakeholder <ul style="list-style-type: none"> Inconsistent approaches across similar entities and across jurisdictions. Fails to reflect the importance of, narrative reporting across all sectors and across the world and the transparency that results.
Alternative 2 Apply existing international guidance on narrative reporting, tailored as appropriate for reporting in the NPO context.	<ul style="list-style-type: none"> Narrative reporting is required to accompany the financial statements based on additional guidance drawing on international guidance on narrative reporting. 	Technical <ul style="list-style-type: none"> Meets the requirements/ recommended practice of IFRS and IPSAS. Practical <ul style="list-style-type: none"> Clear framework providing principles for the basis of narrative reporting. Stakeholder <ul style="list-style-type: none"> Better communication with all stakeholders, with improved and fuller understanding by all stakeholders of the performance, position and prospects of NPOs. 	Practical <ul style="list-style-type: none"> NPOs may have to apply greater judgement in difficult areas, such as forward-looking information and non-financial measures and indicators. Stakeholder <ul style="list-style-type: none"> May be less faith placed in such information, given the lower level of assurance by auditors. Cost/benefit <ul style="list-style-type: none"> Will result in additional narrative disclosures to prepare.

	Description	Advantages	Disadvantages
Alternative 3 Apply integrated reporting, following the IIRC Framework, tailored as appropriate for reporting in the NPO context.	<ul style="list-style-type: none"> NPOs to produce an integrated report in line with the IIRC Framework, providing insight of each of the six capitals. Would incorporate alternative 2 but go beyond it in the provision of a wider integrated report. Additional guidance to assist NPOs in applying the framework. 	<p>Technical</p> <ul style="list-style-type: none"> Meets the requirements/ recommended practice of IFRS and IPSAS Could put NPOs at the forefront of corporate reporting. <p>Practical</p> <ul style="list-style-type: none"> IIRC Framework provides a great deal of flexibility in how organizations report, allowing them to develop their reporting over time. Clear framework providing principles for the basis of narrative reporting. Provides an opportunity to address/change internal management processes to achieve integrated management. <p>Stakeholder</p> <ul style="list-style-type: none"> Better communication with all stakeholders, with improved and fuller understanding by all stakeholders of the performance, position and prospects of NPOs. 	<p>Practical</p> <ul style="list-style-type: none"> Will involve NPOs in having to apply greater judgement in determining narrative reporting disclosures in difficult areas, such as forward-looking information and non-financial measures and indicators. Need to address/change internal management processes (which could also be an advantage). <p>Stakeholder</p> <ul style="list-style-type: none"> May be less faith placed in such information, given the lower level of assurance by auditors. <p>Cost/benefit</p> <ul style="list-style-type: none"> Could place administrative burdens on NPOs to understand and report on issues/areas that go beyond GPFR. Uncertainties about the cost of preparation of an integrated report.

Specific Matters for Comment

1. Do you agree that the list of alternative treatments that should be considered is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.
2. Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment? If you do not agree, please set out the changes you propose, and why these should be made.
3. Please identify the alternative treatment that you favour, and the reasons for your view.
4. Should narrative reporting guidance be set at the level of a framework and principles, rather than any more specific reporting requirements or recommendations? If you disagree, what additional guidance on what specific reporting requirements or recommendations would be beneficial?

[Draft generic questions for further discussion]

Annex A – Narrative reporting – analysis to support alternatives

	IFRS and IPSAS	IIRC	UK	Australia	New Zealand	Canada	USA
Alternative 1 Leave organisations/ jurisdictions to follow existing guidance on narrative reporting by NPOs.				No specific Guidance provided. At federal level, charities provide a regulatory return (Annual Information Statement, AIS) to the Australian Charities and Not-for-profits Commission (ACNC).		No specific guidance provided. At federal level, registered charities must file a Registered Charity Information Return with the Canada Revenue Agency (CRA).	No specific guidance provided. At federal level, the Internal Revenue Service (IRS) form requires information on program accomplishments.
Alternative 2 Apply existing international guidance on narrative reporting, tailored as appropriate for reporting in the NPO context.	IFRS Practice Statement <i>Management commentary</i> is described as a narrative report that provides a context within		The Charities SORP specifies that the report, taken together with the accounts, should provide a picture of what the charity has done (its		Large NPOs with public accountability (Tier 1), plus NPOs that have total expenses greater than NZ\$2 million but less than		

	IFRS and IPSAS	IIRC	UK	Australia	New Zealand	Canada	USA
	which to interpret the financial position, financial performance and cash flows of an entity. It also provides an opportunity to explain objectives and its strategies for achieving those objectives. IPSAS RPGs.		outputs) or achieved (its outcomes), or what difference it has made (its impact). It requires, among other things, information about a charity's objectives, activities achievements and performance.		NZ\$30 million are required to provide, contextual information about the entity, what it intends to achieve over the medium to long term, and how, plus information about achievements in working towards its broader aims and objectives.		
Alternative 3 Apply integrated reporting, following the IIRC Framework, tailored as appropriate for reporting in the NPO context.		As well as information on the six capitals referred to in paragraph 3.7, the <IR> Framework specifies a number of					

	IFRS and IPSAS	IIRC	UK	Australia	New Zealand	Canada	USA
		content elements: a. Organizational overview and external environment; b. Governance; c. Business model; d. Risks and opportunities; e. Strategy and resource allocation; f. Performance; g. Outlook.					
Standards/ Guidance References	IFRS Practice Statement (2010) <i>Management Commentary</i> .	IIRC <i>The International <IR> Framework</i> (2013).	Charities SORP (FRS 102) (Second Edition, October 2019) <i>Accounting and reporting by charities: the</i>	No specific guidance but the Australian Accounting Standards Board (AASB)	Public Benefit Entity (PBE) Financial Reporting Standard (FRS) 48 <i>Service Reporting Performance</i> .		



INTERNATIONAL FINANCIAL REPORTING FOR NON PROFIT ORGANISATIONS

	IFRS and IPSAS	IIRC	UK	Australia	New Zealand	Canada	USA
	IPSAB Recommended Practice Guidance (RPG) 2 (2013) <i>Financial Statement Discussion and Analysis</i> ; RPG 3 (2015) <i>Reporting Service Performance Information</i> . See paragraph 3.3.		<i>statement of recommended practice (SORP)</i> . See chapter 1 <i>Trustees' annual report</i> .	has project plans for both management commentary and service performance information.			