

Technical Advisory Group

Issue Paper

AGENDA ITEM: TAGED03-01
05 October 2021 – Online

Analysis of responses to Consultation Paper Part 1 and initial proposals for formal response and changes to approach

Summary	This paper builds on the analysis of responses received for Part 1 of the Consultation Paper provided in TAGED02 01, with a focus on key themes that have emerged from further review of the responses. It also provides an initial view on how the Secretariat intends to formally respond to the issues raised by respondents to Part 1 of the Consultation Paper, and initial proposals for any changes to approach recommended for the Exposure Draft.
Purpose/Objective of the paper	To allow TAG members to consider key themes arising from the consultation responses, to comment on the Secretariat's initial view on the formal response to issues raised, and initial proposals for changes in approach recommended for the Exposure Draft.
Other supporting items	TAGED02 01 <i>High Level Response Summary</i> TAGED02 02 <i>Guidance form</i>
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Actions for this meeting	Comment on the Secretariat's initial view on the formal response to issues raised and the initial proposals to changes to approach recommended for the Exposure Draft to enable their further development ahead of the December 2021 meeting

Technical Advisory Group

Consultation Paper Part 1 responses and initial proposals for formal response and changes to approach

1. Background

- 1.1 At TAGED 02 an initial high level summary of responses to Part 1 of the Consultation Paper was provided to the TAG. The paper provided an overview of the respondents to Part 1, the extent to which the proposals put forward in the Consultation Paper were supported, and high level comments summarising the responses to the proposals in each Chapter.
- 1.2 This paper provides a further analysis of the responses received, including some from respondents that were not available at the time of the prior paper, with a focus on key themes that have emerged from the review. It also provides an initial view on how the Secretariat intends to formally respond to the issues raised by respondents, and initial proposals for any changes to approach that are being recommended for the Exposure Draft.
- 1.3 For each Chapter of Consultation Paper Part 1 it provides TAG members with an overview of the Chapter content and the General Matters for Comment, detail on responses received including the key themes that have emerged. It also provides initial views on how the Secretariat intends to formally respond to the issues raised and initial proposals for any changes to approach that are being recommended for the Exposure Draft.
- 1.4 Based on the feedback obtained from the TAG to these initial views and proposals, final views and proposals will be developed as part of the formal response to the feedback obtained on Part 1 of the Consultation Paper. This will be presented to the TAG at its December 2021 meeting for comment and will inform the work being undertaken on the 'landscape' sections of the Exposure Draft.
- 1.5 As highlighted in TAGED02-02 *Guidance Form* at this stage it is expected that the 'landscape' section of the Exposure Draft will cover the Preface, Non-profit organisations, and concepts and pervasive principles sections of the standalone Guidance. It will also be relevant for further work in the area of Narrative Reporting that is also being covered in Issue 10 of Part 2 of the Consultation Paper.

2. Chapter 1: What are Non-profit organisations?

- 2.1 Chapter 1 of the Consultation Paper looked at what is meant by the term 'NPOs' to enable an examination of which organisations' financial reports might be addressed by the project's first objective - to improve the quality, transparency and credibility of NPO financial reports.
- 2.2 The Consultation Paper proposed a broad characteristics approach to describing the entities that the IFR4NPO Project Guidance is expected to primarily benefit. NPOs are organisations that:
- Deliver services for public benefit and/or
 - Direct any profits/surpluses for public benefit and/or
 - May have significant voluntary funding and grant income and/or
 - Hold and use assets for social purposes.
- 2.3 The aim of this broad description was to enable a project focus on proposals that best meet the needs of the organisations with some or all of these characteristics.
- 2.4 Respondents to the Consultation Paper were asked:
- GMC1a – Do you agree with the broad characteristics proposed in Chapter 1 for describing NPOs?
- 2.5 As highlighted in TAGED02-01 *High Level Response Summary* there was a high level of support for both the broad characteristics approach and the individual characteristics that were proposed. There were though a number of responses which provided additional commentary on the approach and characteristics, including those where there was only partial agreement or disagreement.

Is the broad characteristics approach the correct approach?

- 2.6 There were a small number of respondents who did not support a broad characteristics approach. They instead argued for a more narrow focus, with only those entities having a specific legal status as an NPO, or those entities that solely operated on the basis of donations, being within scope for the Guidance.
- 2.7 The view of the Secretariat is that this narrow approach would not support the achievement of the projects first objective. Not all jurisdictions have a relevant

legal framework that would permit a narrow legal status approach. Furthermore entities that are deemed to be NPOs in one jurisdiction's legal code may not be deemed to be an NPO in another jurisdiction despite them being structured in the same way and carrying out the same activities.

- 2.8 Furthermore, a focus only on those entities operating solely on the basis of donations or some other single characteristics as noted by a small number of other respondents would also scope out a very large number of entities that would benefit from the Guidance.
- 2.9 As such, and given the high level of support from respondents, a broad characteristics approach is deemed by Secretariat to be the best approach to describing the entities whose financial reports will be addressed by the project. This will be reflected in the formal response to the Consultation Paper feedback and will be taken forward for the Exposure Draft.

Do we have the right broad characteristics?

- 2.10 With respect to whether the Consultation Paper included the right broad characteristics, however, the feedback from some respondents would indicate that there is some further work to do in this area. This feedback was primarily from accounting standard setters and accountancy bodies, but also included a number of individual responses.
- 2.11 These respondents indicated that the characteristics put forward in the Consultation Paper could have unintended consequences with respect to the scope of the entities covered by the Guidance. This was partly due to the presentation of the characteristics as “and/or” statements, but also due to how each individual characteristic might be applied and uncertainty as to what key terms included in the characteristics meant.
- 2.12 In their responses they noted for example that the characteristics might call for the inclusion in scope of a wide range of entities that they did not expect to be an appropriate focus for the Guidance. These included:
- government entities that should follow public sector accounting standards;
 - private sector entities like hospitals that provide services for the public benefit or use assets to fulfil a social purpose but which would be expected to follow private sector accounting standards, and

- certain types of organisations providing benefit only to a small and privileged membership that could be deemed too exclusive to be viewed as a non-profit organisation.

2.13 As well as scoping in entities that they did not believe were an appropriate focus for the Guidance, some respondents also noted that the broad characteristics currently proposed might exclude entities that they believed should be within scope. Examples included:

- entities providing goods for public benefit and not services,
- grant-giving bodies providing funding to other NPOs, and
- entities that work to preserve and enhance the environment, heritage assets, or other areas that might not immediately be deemed to be for a “social” purpose.

2.14 In addition to raising the possibility of unintended consequences with respect to scope, some of these respondents also questioned whether all of the broad characteristics were characteristics in their own right, or should more appropriately be seen as indicators of other characteristics or consequential to activities driven by them.

2.15 Among those respondents providing detailed analysis of this issue, there was support for the retention of the first two characteristics (amended to take into consideration the issues related to scope noted above) with entities having to demonstrate both characteristics. The other characteristics would be then relegated to the status of other indicators or included in additional explanatory material. Their view was that this would benefit the Guidance by ensuring that the broad characteristics approach achieved its objectives while also providing additional clarity to jurisdictions who will ultimately determine which entities would apply the Guidance.

Proposed response to respondents and potential changes to approach for the Exposure draft

2.16 There is sufficient feedback from respondents to indicate that while the broad characteristics approach is the right one, the Secretariat does need to look again at the broad characteristics that were included in Part 1 of the Consultation Paper.

2.17 In the formal response, support for the broad characteristics approach will therefore be reiterated. Given the diversity of entities and jurisdiction-level legal frameworks in which they operate, a narrow description or definition of NPOs

would exclude many organisations that could benefit from the Guidance and is not supported.

2.18 There does appear though to be a need to:

- (i) look at (re)defining some key terms that have caused confusion such as public benefit;
- (ii) amending the broad characteristics to take into consideration issues raised including ensuring the inclusion of entities that provide goods or grant financing; and
- (iii) potentially changing the number of broad characteristics and examining how to provide additional guidance through indicators and other explanatory text in areas like the receipt and provision of funding and the use of assets.

Question 1: On the basis of the feedback from respondents what are the TAG's views on the proposal to (i) retain the broad characteristics approach (ii) undertake the additional work noted on the broad characteristics to address the issues raised, with this to be presented at the next meeting?

3. Chapter 2: NPO stakeholders and their needs

- 3.1 Chapter 2 of the Consultation Paper examined NPO stakeholders and their accountability and decision-making requirements in order to assist in the achievement of Objective 2 of the project – to support the provision of NPO financial information that is useful for decision making and accountability, balancing the needs of preparers and users.
- 3.2 The Chapter proposed that external stakeholders need to know that an NPO is achieving its objectives, in a way that maximises economy, efficiency and effectiveness in the use of resources, while complying with restrictions and regulations, and in the context of its longer-term financial health.
- 3.3 The Chapter also noted that differences in reporting requirements at a jurisdictional-level mean that NPOs have to report using different standards and formats by jurisdiction. This has been a factor in donors imposing their own financial reporting requirements on NPOs. This has led to a significant additional reporting burden for NPOs as they are required to produce different financial reports.

3.4 Respondents to the Consultation Paper were asked:

GMC2.a - Do you agree that NPOs are accountable to service users, resource providers, and regulators and have societal accountability? If not, why not? What alternative groups would you propose NPOs can be accountable to, and why?

GMC2.b - Do you agree that external stakeholders require information on an NPO's achievement of objectives, economy efficiency and effectiveness, compliance with restrictions and regulations, and longer-term financial health, for accountability and decision-making purposes? If not, why not? What alternative areas would you propose and why?

GMC2.c - Do you agree with the issues that have been identified with current accountability and decision-making arrangements for NPOs? If not, why not? Are there any other issues with current accountability and decision making arrangements, particularly financial accountability to donors, that you would wish to highlight?

3.5 As highlighted in TAGED02 01 *High Level Response Summary* there was a high level of agreement across all three of these GMCs from respondents. There were though also some consistent issues raised by a number of respondents which require further examination. These include:

- (i) whether some key stakeholders have been missed,
- (ii) disagreement as to some of the information needs presented and the difficulty in including this information in GPFRs,
- (iii) a view that the focus of this Chapter was too broad and needs to be articulated specifically from the perspective of financial reporting and financial statements – including defining primary user(s), and
- (iv) the need to realise the limits of the project and recognise that there will still be a significant requirement for other forms of financial reporting to donors and regulatory bodies.

Have key stakeholders been missed?

3.6 A number of respondents indicated that the focus on external stakeholders meant that recognition had not been given to 'internal' stakeholders who are also important in the NPO context. This was raised as an issue by a diverse cross-section of respondents including standard setters, academics, and individuals working within the NPO sector from a wide range of different jurisdictions.

- 3.7 Examples provided by these respondents of internal stakeholders included those charged with governance, staff, volunteers, and members. Given the broad accountability perspective of the Chapter and the nature of many NPOs, it is accepted that there is an argument for the inclusion of these groups.

Have information needs been correctly articulated?

- 3.8 Several respondents also questioned the information needs that were presented in the Chapter and provided arguments for some that had not been included. This related in particular to an apparent absence of the outcomes achieved by the NPO, the view that stakeholders needed to understand whether an NPO was maximising economy, efficiency and effectiveness in the use of resources, and the narrow focus on the long-term financial health.
- 3.9 Outcomes had been intended to be partly covered under “achievement of objectives” but the number of respondents who raised this as an issue would indicate that from their perspective this was not adequately covered in the Consultation Paper and needs to be explicitly drawn out.
- 3.10 With respect to economy, efficiency and effectiveness, while most respondents did agree that ‘value for money’ considerations did have at least some relevance to NPOs, a term such as optimisation was preferred to maximisation to better reflect how resources are used to support activities and achieve outcomes. There was in particular a concern raised by many respondents from within the sector, including some donors, that efficiency was a nuanced concept in the NPO context and that a narrow view of efficiency was not appropriate
- 3.11 The focus on long-term financial sustainability was also raised by several respondents who questioned whether stakeholders would also not expect to see areas such as risk, long-term strategy and plans and environmental sustainability covered. These respondents, again many of whom were individuals working in the sector, supported a broader sustainability perspective beyond that presented in the Consultation Paper.
- 3.12 In addition to the specific information needs presented, a number of respondents and in particular one regulator also raised the difficulty in defining and evaluating these areas with performance metrics that would permit meaningful and realistic comparisons of financial and non-financial performance. This was deemed particularly difficult in the context of GPFs which may be subject to audit.

Do we need to articulate information needs from the perspective of financial reporting rather than more broadly?

- 3.13 A number of the standard setter and accountancy institute respondents who provided suggestions to improve the information needs presented also expressed the viewpoint that the focus of the Chapter was not sufficiently tied to financial reporting. Their view was that rather than articulate accountability needs from a broad perspective it should be focussed specifically from the perspective of GPFR.
- 3.14 For these respondents, the broad perspective presented did not allow for a specific focus on the objectives of financial reporting and financial statements. For some this meant that there was insufficient emphasis placed on the role that financial statements play in demonstrating accountability and stewardship, with instead too much emphasis on decision-making usefulness. For them this had led for example to a lack of acknowledgement that areas such as the use of restricted funds were crucial in demonstrating accountability for many NPOs.
- 3.15 It was also argued that the broad perspective meant that the primary user(s) of NPO financial statements which would be important for the development of the Guidance had not been well articulated. Of the key stakeholder groups highlighted, some respondents argued that they would typically and appropriately obtain information by other means rather than through GPFR. For these respondents it was necessary to determine those for whom information would be most appropriately provided to through financial statements.

Have continued requirements for other forms of reporting been underplayed?

- 3.16 There were also some respondents, again primarily from the standards setter and accountancy institute community, who felt that the Consultation Paper could be clearer in noting that whilst GPFR undoubtedly did play a key role in relation to accountability and decision-making, they were not a panacea and other source of information would continue to be required support these activities.
- 3.17 These respondents accepted that whilst the Guidance did have the potential to lead to more consistent presentation in how the financial information requested by donors is measured and reported, it wouldn't remove the requirement for it to be prepared and reported. Donors and other funders would retain a privileged position with respect to being able to require special purpose financial reports. And regulatory bodies too would also continue to request information

from NPOs outside of any GPFR reporting processes supported by the Guidance.

- 3.18 Given this continued requirement for other forms of reporting from donors, funders and regulatory bodies, these respondents argued that the particular information needs of these stakeholders should be understood and the impact of the Guidance on the current reporting burden not be overstated.
- 3.19 The Consultation Paper does recognise that other forms of reporting will still be required, with donors, funders and regulators having the power to request special purpose financial reports from NPOs. The IFR4NPO project and Guidance can, however, support a reduction in the reporting burdens on NPOs, as greater consistency in requirements at the level of GPFRs will enable these stakeholders to make greater use of these financial reports. The introduction of common financial reporting standards also has the potential to reduce diversity in different reporting requirements if adopted by donors for any continued special purpose financial reports requested from NPOs. The Secretariat does agree with the views of respondents that understanding the information needs of donors, funders and regulatory bodies is important to ensuring that financial reporting standards in the Guidance will assist in achieving this.

Proposed response to respondents and potential changes to approach for the Exposure draft

- 3.20 The purpose of Chapter 2 was to examine NPO stakeholders and their accountability and decision-making requirements in order to assist in the achievement of Objective 2 of the project - to support the provision of NPO financial information that is useful for decision making and accountability, balancing the needs of preparers and users.
- 3.21 While there was a significant level of agreement from respondents to the NPO stakeholders identified, their information needs, and the issues identified with current accountability and decision-making arrangements, a number of respondents provided comments that need to be taken into consideration.
- 3.22 In the formal response, Secretariat proposes that the issues raised by respondents in these areas are recognised and agreement is noted that as the project moves to the Exposure Draft stage it will be necessary to articulate clearly who the primary users of NPO GPFRs are and their accountability and decision-making needs.

3.23 Secretariat will undertake the following additional work which will be presented to the TAG at the next meeting and support both the formal response and the development of the Exposure Draft:

- (i) Re-examining the key stakeholders to integrate 'internal' stakeholders and other similar groups;
- (ii) An initial determination of who the primary users of NPO GPFRs; and
- (iii) An initial articulation of the financial and non-financial information needs of these primary users specifically with reference to GPFR.

Question 2: On the basis of the feedback from respondents what are the TAG's views on the proposal to (i) recognise the issues raised and note agreement that as we move to the Exposure Draft stage it will be necessary to articulate who the primary users of NPO GPFRs are and their accountability and decision-making needs (ii) undertake the additional work noted, with initial thoughts to be presented at the next meeting ahead of development at Exposure Draft stage?

4. Chapter 3: What are the essential factors of NPO financial reporting guidance?

4.1 Chapter 3 of the Consultation Paper explained the rationale for two core premises proposed for the development of NPO financial reporting guidance that are essential to meeting stakeholder and user needs and the three Guidance objectives. These were:

- accrual-based accounting; and
- the inclusion of non-financial reporting information

4.2 Respondents to the Consultation Paper were asked:

GMC3a - What, if any, do you see as the main challenges with Guidance that is accrual-based?

GMC 3b - What, if any, do you see as the main challenges with Guidance that includes non-financial information reporting?

Accrual-based Guidance – disagreement with accruals as an accounting basis

- 4.3 As highlighted in TAGED02 01 *High Level Response Summary*, a wide range of responses were received highlighting the challenges of accrual-based Guidance. In the main these were focussed on practical issues around implementation, although several respondents did raise more theoretical challenges to the use of accruals.
- 4.4 A diverse range of respondents including individuals, accounting firms and institutes, and standard setters indicated that smaller less complex NPOs in particular were unlikely to gain any significant benefit from accrual-based Guidance. Reasons noted included their stakeholders having little understanding of accruals and their transactions being simple and adequately accounted for on a cash basis. The ability of users to understand accrual-based financial reports was also raised by other respondents, who indicated that donors in particular were only interested in cash-based utilisation of funding provided to NPOs.
- 4.5 The Consultation Paper did recognise that for many “smaller” and/or less complex NPOs, cash-based accounting would continue to be appropriate and so the Secretariat is in agreement with these respondents. The challenge that the Secretariat has always recognised and which will be covered in the discussion on responses to Chapter 5 is determining which NPOs this would or should include.
- 4.6 Other respondents indicated that donors and regulators would continue to require cash or modified cash basis reports to understand the utilisation of funding or for tax or other purposes. As highlighted above the Secretariat recognises that there may continue to be a requirement for other forms of reporting by NPOs, including reporting using a different accounting basis. As noted the Guidance can, however, support a reduction in the reporting burdens on NPOs, as greater consistency in requirements at the level of GPFRs will enable stakeholders to make greater use of these financial reports. The introduction of common financial reporting standard also has the potential to reduce diversity in different reporting requirements if adopted by donors for any continued special purpose financial reports requested from NPOs.
- 4.7 Finally some respondents, in particular individuals working in NPO finance functions or supporting NPO financial management, did raise specific accounting issues with the application of an accrual approach in the NPO context. This included challenges such as the provision of funding for capital expenditure and a mismatch between income recognition and expenditure leading to an apparent surplus, and the recognition of income from grant and contract

funding. The Secretariat's view is that while valid concerns none of the issues raised are so fundamental as to make an accruals-basis for the Guidance inappropriate in the NPO context.

Accrual-based Guidance – practical issues with implementation

- 4.8 Practical issues with implementation received the most widespread feedback of any of the GMCs in Part 1, being raised by a large number of respondents from different professional backgrounds and jurisdictions. These practical issues were considered in some detail in TAGED02 01 *High Level Response Summary* but are worth reiterating here given the level of response.
- 4.9 The most common response from respondents was in relation to the capacity and capability of NPOs and their staff to move to and maintain an accruals-based accounting system. It was noted that many NPOs rely on volunteer and/or non-specialist staff who would not have the skills and technical expertise required to operate finance systems on an accrual basis, or understand the accrual based financial reports that they produced.
- 4.10 Respondents also commented that access to, and the affordability of, the education and training needed to apply accrual accounting would be challenging in many jurisdictions.
- 4.11 A number of respondents further noted that the resources needed to introduce the computer software and hardware that would be required for accrual accounting would be scarce for many NPOs. And the additional costs associated with compliance and audit of accrual-based financial reports would pose additional burdens.
- 4.12 The Consultation Paper did recognise many of these disadvantages associated with the accrual basis. The feedback from respondents does, however, add additional weight to the need to ensure that the Guidance provides for proportionate financial reporting requirements that can practically be applied by a wide range of NPOs in many jurisdictions.

Non-financial information reporting – challenge in developing Guidance

- 4.13 Although the GMC was primarily focussed on understanding challenges in including non-financial reporting principles within the Guidance, there was recognition from many respondents that it was important to include non-financial information reporting within the Guidance. These respondents, which

mainly comprised accountancy institutes and regulators but also included others including individuals working in the sector, agreed that its inclusion would be beneficial in enabling NPO financial reports to meet the broader needs and expectations of users.

- 4.14 These respondents did, however, raise several challenges to developing non-financial information reporting principles within the Guidance as was highlighted in TAGED02 01 *High Level Response Summary*. At the time of this paper, further detailed analysis of responses to Issue 10 *Narrative Reporting* in Part 2 of the Consultation Paper has yet to be undertaken. The additional detail from these responses will, however, be available to support additional work in this area in advance of the next meeting.
- 4.15 Examining the Part 1 responses, many respondents highlighted that scope would be a key challenge, with a need to think carefully about what to include to ensure comparability and consistency between NPOs whilst also being relevant and applicable across such a diverse range of entities.
- 4.16 In this regard one regulator indicated that as there are a number of international initiatives ongoing to develop international non-financial reporting frameworks, timing was a critical consideration. They felt that the Guidance should leverage from these activities and that while these frameworks were still being developed it would be useful to focus on high-level principles initially before developing detailed Guidance from them.
- 4.17 Given the diversity of NPOs and their activities, other respondents also indicated that a careful balance would need to be struck between prescription and flexibility, with NPOs having the freedom to report in a way that best met their user's needs while ensuring consistency in the application of high level-principles.
- 4.18 An accounting firm also highlighted that the reliability and integrity of data that would potentially be utilised for non-financial reporting requirements needed to be considered, including the extent to which it was auditable or subject to other forms of assurance. In relation to some NPOs, individual respondents also questioned the extent to which non-financial information reporting would build on or integrate with existing NPO performance reporting to donors and other stakeholders.

Non-financial information reporting – practical challenge for NPOs in producing and reporting

- 4.19 As with the responses that indicated challenges related to Guidance that was accrual-based, a number of more practical issues for NPOs in producing and reporting non-financial information were raised by a diverse group of respondents.
- 4.20 Many of these issues were similar to those raised in relation to accrual-based reporting, and related to the capacity and capability of NPOs to collect, verify and report relevant data. Respondents noted, however, that it can be significantly more difficult to measure than financial information. This raises issues in relation to cost, skills and technical expertise that will need to be taken into consideration as Guidance is developed, particularly if entities may also be transitioning to accrual-based accounting at the same time. For this reason one NPO respondent noted that it may be beneficial if non-financial information reporting's inclusion in the Guidance were delayed until a later stage of the project.
- 4.21 In addition, several respondents also questioned how the Guidance would deal with the issue of subjectivity and ensure that NPOs were able to report in a way that was fair and balanced. This links to the challenge noted above about the extent to which non-financial information is auditable or subject to other forms of assurance. It also raises questions as to whether the inclusion of non-financial information reporting could, however, detract from improvements to financial information reporting.

Proposed response to respondents and potential changes to approach for the Exposure draft

- 4.22 The purpose of Chapter 3 of the Consultation Paper was to explain the rationale for two core premises proposed for the development of NPO financial reporting – namely accrual-based accounting and the inclusion of non-financial reporting information. These were deemed necessary to meet stakeholder needs and the objectives of the project.
- 4.23 A large number of challenges were raised by respondents. Many of these were recognised in the Consultation Paper, and were common to issues that could be anticipated in introducing and applying accrual-based accounting and non-financial reporting information across any organisation, sector or jurisdiction. Although anticipated they do though remain valid concerns that need to be addressed.

- 4.24 In the formal response it is proposed that the Secretariat recognises the issues raised by respondents in relation to Guidance that is accruals-based, particularly in relation to capacity, skills and expertise. This does require the Secretariat to consider further how we can ensure proportionate application of accrual-based Guidance while recognising that ultimately whether it will be applied or not and by which entities will be a jurisdiction level decision.
- 4.25 For the Exposure Draft, it is proposed that accrual-based accounting remains a core premise. As noted below in the response to Chapter 5, at present the project does not intend to develop 'tiered' levels of Guidance, so the Guidance will at least initially primarily benefit more complex NPOs that have diverse sources of funding and operations. The extent to which tiered Guidance should be considered in the longer term to potentially broaden the scope of entities that could apply the Guidance may, however, need to be examined at a later stage subject to resource availability.
- 4.26 In relation to non-financial information reporting, while respondents did support its inclusion, responses also seemed to favour an initial focus on high-level principles rather than any detailed prescriptive framework.
- 4.27 In order to ensure that the formal response takes into consideration all relevant information in this area, additional analysis will be undertaken of responses to Issue 10 *Narrative Reporting* in Part 2 to further guide the formal response and additional work in this area for the Exposure Draft. This will be presented at the next meeting.

Question 3: On the basis of the feedback from respondents what are the TAG's views on the proposal to (i) recognise the practical challenges raised to applying an accrual based accounting framework in the formal response but continue to support accrual-based accounting as a core premise as we move to the Exposure Draft, and (ii) undertake additional analysis of non-financial information reporting through review of Issue 10 *Narrative Reporting* in Part 2 of the Consultation Paper to further guide the formal response and additional work in this area for the Exposure Draft.

5. Chapter 4: How far can existing international financial reporting frameworks assist NPOs?

5.1 Chapter 4 of the Consultation Paper highlighted that limitations on time and resource available to the IFR4NPO project means that the Guidance must be based on existing financial reporting frameworks. It developed an argument for why the Guidance needs to be based primarily on an international rather than jurisdictional-level framework, examining the extent to which the three existing international frameworks would allow the project objectives to be met, and therefore whether they might be suitable as a basis for the Guidance. A high-level assessment was also provided to consider the extent to which NPO-specific reporting issues are already addressed by the frameworks.

5.2 Respondents to the Consultation Paper were asked:

GMC 4a Do you agree that international frameworks are the best start point for the guidance?

GMC 4b Do you agree with the criteria that have been used to assess the suitability of the existing international frameworks?

GMC 4c Do you agree with the high level assessment of the existing international frameworks against these criteria?

Is the use of existing international frameworks supported?

5.3 There was a high level of support from respondents for the use of existing international frameworks. Most respondents agreed with the view expressed by one standard setting body that that this was a pragmatic approach given the time and resource constraints on the project and that there were significant advantages in being able to leverage the work that had been undertaken to develop and maintain these frameworks. Examples provided by respondents included the extensive consultation and best practices associated with these frameworks, the potential for familiarity amongst preparers and users, and also the existence of extensive educational and support material.

5.4 One accounting firm questioned whether consideration had been given to utilising jurisdictional-level frameworks as the start point. This is addressed in the Consultation Paper, where it was explained that this was considered but deemed not to be the best approach because jurisdictional-level frameworks are not developed with international application in mind and are subject to jurisdictional-level rather than international due process.

- 5.5 An academic respondent also questioned the extent to which Guidance based on international frameworks would be acceptable to disadvantaged countries and regions who have limited input into their formulation. This adds further weight to the need to ensure effective global outreach so that the development of IFR4NPO remains as inclusive as possible.
- 5.6 There were a limited number of respondents, however, who disagreed with the use of existing frameworks, arguing that an entirely new framework for NPOs was required starting with the development of an NPO conceptual framework.
- 5.7 The IFR4NPO project does not have sufficient resources to develop a new conceptual framework and complete suite of NPO financial reporting standards from scratch. There are also examples from across the globe of jurisdictions that have adapted existing international frameworks to develop NPO financial reporting frameworks that demonstrate that an adaptive approach can succeed. It is recognised though that IFRS and IPSAS have developed financial reporting standards for for-profit organisations and government entities to meet their own sector context and the needs of their primary users of financial statements.
- 5.8 As noted in the proposed formal response to feedback received on Chapter 2, the Secretariat agrees that as the project moves to the Exposure Draft stage it will be necessary to determine who the primary users of NPO GPFRs are and articulate the financial and non-financial information needs of these primary users specifically with reference to GPFR. This will assist further in identifying NPO specific issues and guiding standard development.

Were the right criteria used to assess the international frameworks?

- 5.9 A significant majority of respondents agreed with the criteria used to assess the existing international frameworks, with only a small number of respondents suggesting different or additional criteria.
- 5.10 One regulator noted that there was a need for clarity on the interaction between the criteria and the project Guidance objectives, and that the assessment of a framework's ease of use should more clearly evaluate its impact on NPO financial reports and whether this information is proportionate to the needs of both preparers and users. This was supported by an accountancy institute, who noted that there was a need to ensure that the frameworks would provide financial reports suitable for their primary users.
- 5.11 Other responses suggesting modifications to the assessment criteria included a suggestion of an additional criteria that takes into account the alignment of the

framework with the four characteristics of an NPO, and a criteria that would assess the ease or difficulty of convincing stakeholders to adopt the resulting standard.

- 5.12 Again, however, there were some comments on issues related to the lack of a specific NPO conceptual framework, including specific statements about who the users are and what user needs will be met through financial reporting that is prepared using those standards, that would underpin the Guidance. For some respondents this meant that it was inappropriate to use existing international frameworks and a new framework had to be developed. For others who highlighted the broad discussion on accountability and decision-making in Chapter 2, this meant that IPSAS was better aligned than IFRS or IFRS for SMEs. This is further discussed below.

Was the high level assessment of the frameworks against the criteria supported?

- 5.13 Again a significant majority of respondents agreed with the high level assessment of the frameworks against the criteria, although some questioned individual ratings that had been provided in certain areas and one standard setter noted that all ratings should be red, as the frameworks did not provide standards tailored to NPOs.
- 5.14 With relation to the individual ratings, this included whether the red assessment on accounting for non-financial assets applied to IFRS and IFRS for SMEs should instead be amber. A standard setter also questioned the extent to which regular updates to IFRS and IPSAS are really more demanding than the less frequent but potentially more significant changes to IFRS for SMEs approximately every five years.
- 5.15 Further support was provided in the responses to the use of IPSAS. One standard setter questioned whether given that the focus of the Guidance would initially be on more complex NPOs, IPSAS wouldn't be the more logical foundational framework. They argued that IPSAS would be more closely related to the underlying nature and purpose of the organisations and users of financial statements that the Guidance was being developed for. In a similar vein, comments were also received on the need to focus on who the primary users of NPO financial statements will be when assessing the frameworks and not the broad range of stakeholders identified in Chapter 2.
- 5.16 Finally one standard setting regulatory body indicated that in their view adapting IPSAS or IFRS was a flawed solution in the longer term, but that in the interests

of creating the foundations for the next stage of the project offered a promising start.

Proposed response to respondents and potential changes to approach for the Exposure draft

- 5.17 The purpose of Chapter 4 of the Consultation Paper was to highlight that resource constraints on the IFR4NPO project meant that the Guidance must be based on existing frameworks, and that it would also be based primarily on an international rather than jurisdictional-level framework. It provided an assessment of the three existing international frameworks and the extent to which they would allow the project objectives to be met.
- 5.18 There was a high level of support from respondents to the proposal that an existing international framework be used as the foundation of the Guidance and also the criteria used to assess them. This provides support for the approach as we move forwards to the development of the Exposure Draft.
- 5.19 In response to those respondents who disagreed with the use of existing frameworks, the Secretariat's view is that it is an unfortunate reality that the project does not have the time or resources to develop an entirely new NPO conceptual framework and suite of financial reporting standards. The Secretariat also notes that a number of jurisdictions globally have successfully adopted international frameworks as the basis for financial reporting standards for NPOs. As noted in the response to Chapter 5, it is also the case that IPSAS, even though it now has its own conceptual framework, has a well-established process for using relevant IASB documents as a starting point for its guidance, with alignment except when there is a public sector issue that warrants departure.
- 5.20 The formal response will therefore reiterate the resource constraints impacting on the project that necessitate the proposed approach, along with global examples of jurisdictions that have successfully used a similar approach and the alignment process utilised by IPSAS which aims to ensure that as far as possible a similar transaction or economic event will be accounted for the same way by a public or private sector entity.
- 5.21 In relation to those respondents who indicated that the assessment criteria needed to be better aligned to the information needs of primary users, it is proposed that the formal response notes that as the project moves to the Exposure Draft stage there will be a more clear focus on the primary users of NPO GPFs and their accountability and decision-making needs in relation to

GPFR specifically. The discussion as to whether IPSAS would be more suitable as a foundational framework will be covered in the response to Chapter 5.

Question 4: On the basis of the feedback from respondents what are the TAG's views on the proposal to (i) reiterate in the formal response the need to use an existing international framework as the foundation of the Guidance given time and resource constraints on the project and highlight examples from around the globe of jurisdictions that have successfully used a similar approach (ii) agree the need to ensure that the information needs of primary users of NPO GPFR are met as the Exposure Draft is developed.

6. Chapter 5: Proposed way forward

- 6.1 The purpose of Chapter 5 was to propose a way forward to meet all the project Guidance objectives. A model was proposed with IFRS for SMEs as the foundational framework with further guidance drawn from full IFRS Standards, IPSAS, and jurisdictional-level standards where IFRS for SMEs is silent or does not provide appropriate and/or sufficient guidance.
- 6.2 It was also proposed that development of the Guidance initially focus on those NPOs that have more complex operations and transactions that they need to account for and/or reporting requirements to funders and jurisdictions where current arrangements for not provide adequate solutions.
- 6.3 Respondents to the Consultation Paper were asked:
- GMC 5a What do you see as the main challenges, if any, with the proposed Guidance model and the use of the IFRS for SMEs Standard as the foundational framework? What, if any, alternative model and/or foundational framework do you suggest would be more suitable and why?
- 6.4 While there was a general understanding of the need for a proportionate and pragmatic solution as proposed in the Consultation Paper, respondents highlighted a number of challenges with the proposed Guidance model from both conceptual and practical perspectives.

Conceptual issues related to the Guidance model and foundational framework.

- 6.5 Several respondents raised conceptual issues related to the proposed Guidance model and the use of IFRS for SMEs as the foundational framework, including questioning whether the use of IFRS for SMEs as the foundational framework was appropriate given that it has a for-profit conceptual basis.
- 6.6 Absent a specific NPO conceptual framework, these respondents questioned how IFRS for SMEs would be applied and how NPO specific financial reporting issues requiring departure from IFRS for SMEs would be identified.
- 6.7 For some of these respondents, including a number of standard setters and academics, this meant that IPSAS would provide a more appropriate foundational framework, as it was more closely aligned to the characteristics of NPOs and the NPO specific financial reporting issues that had been identified.
- 6.8 For other standard setters, who were concerned as to how conceptual coherence would be possible when several different international and jurisdictional-level frameworks would be used to develop the Guidance, it meant additional clarity was needed on the hierarchy of frameworks used to develop the Guidance.

What would the Guidance comprise and which NPOs would be covered by the Guidance?

- 6.9 There was some uncertainty amongst respondents as to exactly what the Guidance would comprise. A number questioned whether it would be a complete suite of standards in one standalone set of Guidance, an annotation of IFRS for SMEs, or if it would be necessary for NPOs to refer to multiple different sources of financial reporting standards.
- 6.10 The status of the Guidance was also raised. A regulator indicated that they were not clear if the term 'Guidance' meant a level of optionality or if the accounting and reporting treatments including in the Guidance would be expected to be mandatory. Other individual respondents questioned whether jurisdictions would require NPOs to apply the Guidance at all when they had their own accounting regulations already in place tailored to their own jurisdictional requirements. An accounting firm also noted the risk that different rates of adoption globally would potentially reduce the comparability of NPO financial and non-financial information.
- 6.11 Uncertainty was also expressed as to which NPOs the Guidance was expected to cover, including the view from one donor that momentum for the project would

be weakened if only some NPOs were covered. A wide range of respondents asked whether consideration had been given to the creation of reporting tiers which would also enable Guidance (potentially on the basis of modified cash or cash) to be provided to smaller less complex NPOs.

Practical considerations related to the adoption of the Guidance

- 6.12 Questions from respondents as to whether reporting tiers had been considered also fed into practical considerations raised in relation to adoption of the Guidance based on the proposed model.
- 6.13 Several respondents noted that even though simplified in comparison to full IFRS Standards and IPSAS, IFRS for SMEs would still lead to complexity, especially in relation to disclosures and notes to the financial statements compared to current requirements for many NPOs.
- 6.14 Individual respondents in particular indicated that this meant that the provision of training and education and implementation guidance would be crucial in supporting adoption of the Guidance. An accountancy institute did note, however, that the use of international frameworks would support this, with another indicating that in relation to IFRS for SMEs in particular there was a significant degree of free education and training materials available.

Proposed response to respondents and potential changes to approach for the Exposure draft

- 6.15 The purpose of Chapter 5 was to propose a Guidance model with IFRS for SMEs as the foundational framework with further guidance drawn from full IFRS Standards, IPSAS, and jurisdictional-level standards where IFRS for SMEs is silent or does not provide appropriate and/or sufficient guidance. It also proposed an initial focus on NPOs that have more complex operations and transactions that they need to account for and/or reporting requirements to funders and jurisdictions where current arrangements for not provide adequate solutions.
- 6.16 As highlighted a consistent challenge from respondents was whether IFRS for SMEs was appropriate as a foundational framework given it has a for-profit conceptual basis. For some this meant that it was necessary to develop an entirely new NPO conceptual framework and suite of financial reporting standards. For others this means that IPSAS would be more appropriate as the foundational framework.

- 6.17 The formal response will reiterate that resource constraints impacting on the project necessitate the use of existing frameworks. In relation to whether IPSAS would be more appropriate as the foundational framework, had an “IPSAS for SMEs” been available then the Secretariat agrees that this may have been deemed to have been a better solution when assessed against the criteria than IFRS for SMEs. However, such a framework does not currently exist.
- 6.18 As such the benefits of IFRS for SMEs, in particular the fact that it provides a shorter, simplified standalone Standard with reduced disclosures, are deemed by the Secretariat to outweigh the conceptual benefits of IPSAS highlighted by respondents. In relation to NPO specific accounting issues, IPSAS will be a key source of accounting and reporting solutions for the Guidance. It is also the case that the IPSASB has a well-established process for using relevant IASB documents as a start point for its guidance, with terminology changes and/or amendments made where necessary for the public sector context. This is similar to the approach taken in the proposed Guidance model and should ensure that maximum benefit is obtained from all of the international frameworks.
- 6.19 In relation to the format of the Guidance, TAGED02 02 *Guidance Form* highlighted that the currently preferred option is for the Guidance to be a set of self-contained guidance that would directly replace sections of the *IFRS for SMEs* standard. This would mean that where IFR4NPO is not directly addressing a topic as part of the project scope, the sections in the *IFRS for SMEs* standard would be extant. This option is a more restricted set of stand alone guidance. This will be indicated in the formal response and will guide the development of the Exposure Draft. The formal response will note that this is the preferred option of the Secretariat and will guide the development of the Exposure Draft.
- 6.20 With respect to the applicability of the Guidance, the Secretariat will note in the formal response that ultimately this will be a decision for individual jurisdictions. Whether all or some of the Guidance will be optional or mandatory for an entity will therefore be the decision of the individual jurisdiction. The Secretariat will also note that at present the focus of the development of the Guidance is on providing reporting guidance that is aimed primarily at meeting the needs of more complex NPOs that have diverse sources of funding and operations. The extent to which tiered Guidance should be considered in the longer term to potentially broaden the scope of entities that could apply the Guidance may, however, need to be examined at a later stage subject to resource availability.
- 6.21 Finally, even though formal reporting ‘tiers’ are not at present being pursued by the project, the practical considerations raised in relation to the proposed Guidance model do require consideration as to how we can ensure proportionate application of accrual-based Guidance given constraints in

capacity, skills and expertise. This will be noted in the formal response and will also need to be a key consideration when examining proposed solutions to NPO specific accounting issues from Part 2 of the Consultation Paper which developing the Exposure Draft.

Question 5: On the basis of the feedback from respondents what are the TAG's views on the proposal to (i) indicate in the formal response that given the need to utilise an existing international framework, the benefits of IFRS for SMEs continue to indicate that it remains the most appropriate foundational framework for the Guidance, (ii) reaffirm that ultimately it will be the decision of individual jurisdictions as to whether or not NPOs will apply the Guidance, and (iii) develop the Exposure Draft in accordance with the form of a restricted set of stand alone guidance.

7. Next Steps

- 7.1 On the basis of the feedback received on these proposals, final views and proposals will be developed as part of the formal response to the feedback obtained on Part 1 of the Consultation Paper. This will be presented to the TAG at its December 2021 meeting for comment.
- 7.2 It will also inform the work being undertaken on the 'landscape' sections of the Exposure Draft over the next six months that will be presented to the TAG in April 2022.

October 2021