

IFR4NPO Project

Discussion Summary and Requests Practitioner Advisory Group meeting

16 March 2022
PAGED05



Attendance

Notes

The meeting was held online, chaired by Tim Boyes-Watson, and attended IFR4NPO Project team members Samantha Musoke, Karen Sanderson, Phil Trotter, Paul Mason and Sarah Sheen in addition to the following PAG members:

Bages Petro, David Gilchrist, Dorothea Malloy, Genny Kiff, Karina Vartanova, Kenneth Makanga, Nigel Davies, Oumou Wane, Philip McMinn Mitchell and Sizwile Sibindi.

Status of this document

- The role of the Practitioner Advisor Group (PAG) is to present the diverse range of perspectives of different users of the guidance that the project aims to develop, giving input to the IFR4NPO Project Team and Technical Advisory Group.
- The PAG is not required to reach consensus and does not make formal decisions or take votes. Opinions shared by individual PAG members are not necessarily those of the entire PAG or the IFR4NPO Project.
- The recording provides a full verbatim account of the views of individual PAG members, any small group discussions are not captured.
- This document serves to record a summary of key opinions shared in the plenary sessions, in the form of a discussion digest, and requests to or from PAG members.
- This document should be read in conjunction with the meeting papers and questions available [here](#).



Session outline

1. Narrative reporting
2. Financial Statement (FS) presentation
3. Reporting entity and control
4. Report from Donor Reference Group (DRG)

1.1 & 2 Narrative reporting: difficulties & proposals

Discussion summary

- In Australia, costs to undertake commentary is a significant issue. There are challenges with the cost of collecting, analysing and auditing data, and questions about the effectiveness of audit assurance.
- Reporting cycle – financial reporting is annual, but programmes may take 1-5 or more years to produce meaningful information or have different cycles.
- The process of developing narrative reports was found to be very valuable internally by Australian NPOs
- UK research shows users want to see the difference the NPO makes.

Requests

- Provide a set of terms and descriptions for these types of reports: narrative, non-financial, performance reporting, goods and services delivery reporting, impact reporting etc.
- Keep communicating to the sector about the positive impacts of narrative reporting

1.1&2 Narrative reporting: difficulties & proposals

Discussion summary

- The use of high level indicators that link to the natural way in which NPOs conduct their business is the best way of maximising value and overcoming practical challenges for preparers. The trade-off is a diversity of reporting metrics.
- [Principles into Practice](#) (2016 initiative in UK) demonstrated that NPOs need a range of metrics, which could be challenging for Guidance looking for harmonisation.
- There is a risk of NPOs reporting 'what their donors want to read' due to fear of punitive responses. It is important that NPOs understand the purpose of these narrative reports.

Requests

- Have some aspects that are required / prescribed but the flexibility for NPOs to add other things

1.1&2 Narrative reporting: difficulties & proposals

Discussion summary

- New Zealand uses [NZ PBE FRS48](#). It is principles based and moved away from terms 'outputs' and 'outcomes'. Narrative reporting on inputs is not that useful as most will be reflected in the financials or notes if they are non-monetary donations (except perhaps volunteer time).
- With respect to narrative reports, the DRG members requested information about governance, strategies, goals, plans and risks, activities, geographic, area, legal status and registration.
- Many preparers will struggle to prepare this report – provide as much explanation, guidance and examples as possible.
- The dimension of 'organisational values' appears to be absent from the proposals, yet it is important and should not be neglected.

Requests

- Have some aspects that are required / prescribed but the flexibility for NPOs to add other things
- Clarify meaning or give examples of 'inputs'.
- Give as much practical guidance and examples as possible, coupled with flexibility

1.1&2 Narrative reporting: difficulties & proposals

Discussion summary

- Much as the proposals are 'principles based', many preparers and auditors end up defaulting to a tick box approach.
- The elements in the proposal look fine, but some language, requires adaptation, such a 'goods and services performance objectives' – it sounds commercial. It does not seem sufficiently tailored or adapted to the sector.
- Performance indicators and success factors could be a challenge because they can be very diverse.
- The Federal Accounting Standards Advisory Board in USA has an active project to review of the [Managements Discussion and Analysis](#) which are required to be produced by all USG entities.

Requests

- Consider disclosure of risks to information quality

1.1&2 Narrative reporting: difficulties & proposals

Discussion summary

- On member noted that it is not uncommon for trustees to be appointed by or approached by management, which can impact effective governance. The member therefore proposed disclosure of the number of board meetings and attendance by individual members.
- 'Fair and balanced' will be a source of tension- a natural desire is to emphasise the upside and downplay the setbacks. By emphasising in the reporting how the NPO is a learning organisation and how it has used challenges or unforeseen setbacks or disappointments to develop and improve offers a mechanism to encourage balance provided such learning is encouraged by stakeholders including donors.

1.1&2 Narrative reporting: difficulties & proposals

Discussion summary

- The UK charity regulators have looked at what motivates donor giving. The findings indicated that donor giving was about- belief in the cause, knowing that the money had been spent on the end purpose (a concern about efficiency delivery and economy in 'administration' costs) and that the giving had made a difference (effectiveness). See report:
https://www.charitysorp.org/media/649771/131120_paper_1_public_trust_presentation.pdf
- There was a desire that a charity lives its values and this ethical aspect is key distinctive of NPOs. Financial reporting needs to speak to these concerns. The approach is good but perhaps is anchored a bit too much in the context of reporting to investors (IFRS) or accountability to taxpayers (IPSAS) and so needs to broaden a little to ethics and values.

1.3 Narrative reporting : sustainability reporting

Discussion summary

- Launched at COP26, the ISSB have produced a framework which can be applied proportionally. It has four elements: Governance, Strategy, Risk & Metrics. This should also be embraced by NPOs too, but as a natural ingredient rather than a whole new framework.
- Sustainability is an important issue, but the basics of financial and results reporting are higher priority. Sustainability reporting could be addressed on a longer time frame.

1.3 Narrative reporting : sustainability reporting

Discussion summary

- Although the full suite of sustainability standards the ISSB are looking to create may not be a suitable framework, the overarching, the 'General Requirements for Disclosure of Sustainability-related Financial Information Prototype' does offer four helpful aspects that might be readily integrated with existing approaches to financial reporting:
<https://www.ifrs.org/content/dam/ifrs/groups/trwg/trwg-general-requirements-prototype.pdf>
 - **Governance:** eg how do those in charge incorporate thinking about sustainability into their oversight of the NPO's activities?
 - **Strategy:** eg how do those in charge incorporate thinking about sustainability considerations when planning and taking forward their NPO's activities?
 - **Risk management:** eg how far have sustainability issues had an impact on the work of and achievements of the NPO in the year and how might they affect future activities?
 - **Metrics/ targets:** eg when incorporating sustainability considerations into the charity's work what do those in charge in governance monitor to see how well the NPO is performing and what were the outcomes for the year? Eg water usage, energy usage, recycling, reducing air or road miles, moving to on-line delivery, employee welfare, homeworking etc
- By integrating it as an aspect of reporting rather than separate requirements this hopefully will avoid adding lots of extra content as extra content adds to length, makes the text harder to follow and might obstruct clear concise reporting that meets stakeholder needs.

2.1 FS Presentation : Name of income statement

Discussion summary

- There was a strong preference for 'Statement of Income and Expenses' over 'Statement of Financial Performance' with members citing the following reasons:
 - Simpler and more easily understood by users.
 - It says what it is.
 - Financial performance is not readily determined from numbers on the statement. General reserves may a better indication of financial sustainability than income or surplus. 'Performance' is mission related.
- One member preferred Statement of Financial Performance and another was ambivalent.

Requests

- The PAG were requested to provide feedback by email on their opinion about the most important high level numbers in the financial statements – and why.

2.1 FS Presentation : Name of income statement

Discussion summary

- One member preferred the term 'profit / loss' because the term surplus / deficit is misunderstood by readers of the financial reports.
- It is was acknowledged that gains are not easily treated within the framework of 'income and expenses.
- One member commented that using revaluation reserves for important assets and liabilities seemed reasonable.
- One member noted that the statements needs to be defined to encompass NPOs with distributions to members eg cooperatives

2.2 FS Presentation: Columns for different funds

Discussion summary

- Opinion was divided about whether the Income Statement should be divided into columns for restricted and unrestricted funds. Most were in favour but arguments against included:
 - It creates many more numbers and can be confusing.
 - Detracts from main information. Unlike other sectors.
- The terms 'restricted and unrestricted' are not self explanatory or readily understood by users
- People generally don't read the notes, it makes sense to separate key numbers on the face.
- One member proposed an option to add other columns if needed, such as disclosing figures in another currency. This could also be in the notes.
- A member noted that the split by fund on the face is more critical for income than for expenditure. This could be done with separate rows rather than columns.

2.3 FS Presentation : Deferral approach

Discussion summary

There was general support for an approach that minimises large surpluses or deficits for the following reasons:

- In the African context, an NPO can struggle to succeed in a tax exemption application if they show a large surplus. Tax officers are rarely skilled in reading NPO financial reports.
- Research in Australia shows strong support for matching principle among NPOs and users. There is concern about reporting surpluses relating to grant income, and evidence that preparers use 'earnings management' techniques to report small surpluses.
- Accounts that show a large deficit (on restricted funds and in total) has led to difficulties such as suppliers refusing credit, potential collaborators being reluctant to partner, and the board not understanding the accounts.
- Without applying appropriate deferral / matching many readers cannot make any sense of the accounts, and that undermines their credibility.

Requests

- Select an approach that minimises volatility in surplus / deficit.



2.3 FS Presentation : Deferral approach

Discussion summary

- Over or under estimating the deferred grant liability could impact on the stability of the financial statements
- Deferral approaches often depend on management assumptions for single or multi-year projects. This reduces the credibility of the financial statements.

Requests

- Ensure any deferral approach is able to be supported by auditable evidence.

2.3 FS Presentation : Deferral approach

Discussion summary

- Deferral of grants with restrictions can result in liabilities that might not meet the IASB definition.
- One member recognised an NPO's grant income in full, in accordance with UK standards, then the donor pulled out and they had to reverse it the following year.
- Information about sustainability and reserves could get concealed if deferral approaches are adopted.
- Matching allows greater subjectivity and the risk of massaging of financial performance. The practice was criticised in the pioneering research 'Financial Reporting by Charities' by academics Peter Bird and Peter Morgan-Jones (1981). An alternative might be to allow budget phasing which is documented with the funder to be a relevant condition affecting the timing of income recognition- an approach taken by the UK Charities SORP (see module 5 paragraphs 5.21 and 5.22).
- One member felt the UK approach with milestones / conditions was very time intensive to apply to a large grant portfolio. It required a dedicated accountant.

2.4 FS Presentation : Supplementary Optional Donor statement(s)

Discussion summary

- A supplementary donor statement will only be useful for NPOs if the specific donor agrees to accept the audit of that financial report in lieu of separate special purpose audited reports.
- There is a risk when donors focus too much on expenditure audits at the expense of mission. If financial assurance was done through the general purpose accounts, then project audits could focus more on performance.
- The donor statement should be reconciled to the income statement, eg if they are on different accounting bases.
- A donor member commented that this approach could channel donors into looking at a standard format for project reporting, with huge potential for good.

3.1 Reporting entity: NPO structures

Discussion summary

- In terms of additional structures, one member suggested an instance where a philanthropist appears to control a charitable entity that it provides funds to, for example if a checklist approach were applied. There could be exemptions for this type of relationship.

Requests

- The PAG member was requested to share details of the examples with the secretariat.

3.2 Reporting entity: principles vs pragmatic approach

Discussion summary

- There were two alternatives to assessing control in the consultation: A principles based definition of control based on IFRS10, and a pragmatic approach based on ability to control financial and operating policies, as used in the *IFRS for SME* standard.
- The pragmatic approach offers familiarity in UK context. Those that have been consolidating will likely have been applying this already.
- The pragmatic approach enables NPOs to define the nature of control in a contextual way, whereas IFRS10 is based on power of financial returns and voting rights, which are not applicable concepts. Even if the Guidance ends up diverging from extant standards in this regard, it is probably appropriate to do so.

3.2 Reporting entity: principles vs pragmatic approach

Discussion summary

- Readers of financial statements are likely to be interested to know which other entities it controls or is controlled by. In this case, simple disclosure may be more effective and less onerous than full accounting consolidation of financial results.
- A pragmatic approach, being less subjective, may be harder for 'controlling entities' to avoid. It will also be simpler and cheaper to be consistently applied. The risk of getting the 'incorrect outcome' because of use of a pragmatic rather than principles based approach could be less problematic if the consequence is disclosure related.
- One member expressed a preference for pragmatic approach with exceptions. For example there can be political issues with churches with more complex structures. There needs to be clear expectations for consolidation and why they are important.
- When asked to choose, 7 members preferred the pragmatic approach, and one the principles based approach.

4 Donor Reference Group (DRG) report

Discussion summary

- A PAG member who is also a DRG member commented that it is beneficial for donors to collaborate to see the larger picture of the burden placed on recipients by donor reporting requirements. The DRG is on a journey to realise the value of what the IFR4NPO project is trying to achieve.
- One member noted that donors tend to use the audit opinion on financial statements as part of a triage process in due diligence, rather than engaging with the numbers specifically.
- With reference to DRG report, one member noted their request for information about foreign currency, such as the currency the financial statements are presented in, and year end exchange rates to relevant international currencies, to support readability by those outside the country. The power of donors to stipulate which exchange rates are used for reporting on their grants creates significant problems and complexity for NPOs. It would be very helpful for the Guidance to provide a standard approach and for donors to accept that.