



Technical Advisory Group Issue Paper

AGENDA ITEM: ED06-03
4 MAY 2022 – Online

Narrative Reporting

Summary	This paper sets out proposals for developing narrative reporting guidance for NPOs taking into consideration the responses received to the Consultation Paper, feedback from the PAG, and the views from a focus group that was held in April 2022.
Purpose/Objective of the paper	This paper provides TAG members with an overview of the responses to the Consultation Paper and describes the proposed approach to developing narrative reporting guidance for the INPAG. As part of the description of the proposed approach it also provides TAG members with an overview of the views of the PAG and additional commentary from a focus group on narrative reporting that was held in April.
Other supporting items	Annex A: Consultation Paper Part 2 Responses
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Actions for this meeting	<u>Note</u> the responses received to the Consultation Paper. <u>Comment</u> on the proposed approach developed for a mandatory core of narrative reporting requirements. <u>Advise</u> on any further specific reporting requirements that may be included as part of the mandatory core.

Technical Advisory Group

Narrative Reporting

1. Background

- 1.1 The IFR4NPO Consultation Paper proposed in Part 1 that one of the core premises of the INPAG if it were to meet Guidance objectives would be the inclusion of non-financial reporting information. This would lead to NPOs producing General Purpose Financial Reports (GPFRs) rather than just General Purpose Financial Statements (GPFS).
- 1.2 A detailed description of the issue was included as part of Issue 10: Narrative Reporting in Part 2 of the Consultation Paper. This highlighted the importance of non-financial information for NPOs to demonstrate accountability and stewardship to stakeholders, and the difficulty caused by varying disclosure requirements globally.
- 1.3 This paper provides the TAG with an overview of the responses to the Consultation Paper and the proposed approach to developing narrative reporting guidance for the INPAG. As part of the description of the proposed approach it also provides TAG members with an overview of the views of the PAG who were taken through the proposed approach at their last meeting and additional commentary from a focus group on narrative reporting that was held in April.
- 1.4 Advice is sought from the TAG on the proposed approach to developing narrative reporting guidance and any additional specific reporting requirements that should be considered.

2. Consultation Paper responses

Part 1

- 2.1 Respondents to Part 1 of the Consultation Paper were asked to provide feedback on what they deemed the challenges would be from guidance that included non-financial information reporting requirements for NPOs.

2.2 At a conceptual level, respondents highlighted the following:

- **Scope** – what to include to ensure comparability and consistency between NPOs whilst also being relevant and applicable across a diverse range of entities.
- **Timing** – the guidance should leverage from initiatives which were ongoing to develop international non-financial reporting frameworks, but as these were still in development consideration needed to be given to the timing of introducing reporting requirements.
- **Prescription and flexibility** - given the diversity of NPOs and their activities, NPOs would need the guidance to provide them with the freedom to report in a way that best met their user's needs, while also ensuring consistency in the application of common high level-principles.
- **Reliability and integrity of data** – including the extent to which non-financial information was auditable or subject to other forms of assurance.
- **Integration with existing reporting** –how best to ensure that the guidance can build on or integrate with existing NPO performance reporting to donors and other stakeholders to reduce reporting burdens on NPOs.

2.3 Respondents also raised a number of more practical challenges including:

- **Capacity and capability** –collecting, verifying, and reporting relevant data would be difficult for many NPOs, as would measuring non-financial information when compared to financial information.
- **Costs, skills, and expertise** – would be limited in some NPOs, especially amongst those that would be transitioning to accrual-based accounting.
- **Subjectivity** – how could the guidance assist in ensuring that NPOs were able and required to report in a fair and balanced way.

Part 2

2.4 For Part 2, respondents were asked to provide feedback on the description of the issue and the alternative treatments proposed (1. Do nothing - 2. Approach based on existing IASB/IPSASB guidance - 3. Approach based on the <IR> framework). They were also asked to provide views on the extent to which the guidance should be set at the level of an overarching framework and high-level principles or include more specific reporting requirements.

2.5 Part 2 responses were supportive of the description of the issue (96% agree) and mainly in agreement with the list of alternatives identified (77% agree). Substantive comments received from respondents included a need for a fuller

understanding of user's needs to determine how they can be met, which could require a solution not presented as an alternative. There was also support for narrative reporting to focus on an NPO's public benefit objectives, its impact, the effectiveness of the organisation's governance structures and processes, and broader sustainability issues, rather than being restricted to financial statements analysis.

- 2.6 With respect to the alternatives put forward in the Consultation Paper there was little support for the do-nothing alternative which was widely seen as a missed opportunity. There was relatively even support amongst those providing a preference for the other alternatives, with the approach based on the <IR> framework (50%) being slightly more favoured than an approach based on IASB/IPSASB guidance (37%).
- 2.7 Those favouring the IASB/IPSASB guidance approach indicated that it would complement the information in the financial statements and would be less complicated for NPOs to apply. Those favouring the <IR> framework approach felt that although more ambitious it offered an opportunity for NPOs to apply emerging best practice and deliver standardised narrative reporting based on stakeholder needs.
- 2.8 In addition to the alternatives proposed, there was also some support expressed for the use of sustainability reporting frameworks. Specific frameworks mentioned by respondents included the GRI Standards and those that will be developed by the IFRS Foundation's International Sustainability Standards Board.
- 2.9 With respect to whether guidance should be set at the level of an overarching framework and high-level principles or if specific reporting requirements or recommendations would be required, the majority of respondents noted that the diversity of NPOs and jurisdictions pointed to the need for a framework and principles solution. Some of these respondents noted, however, that this would need to be backed by detailed guidance on how to apply the framework and principles.

3. Proposed approach for developing the Exposure Draft on Narrative Reporting

- 3.1 Analysis of the responses to the Consultation Paper supports a framework and principles approach that provides a core set of requirements that can be applied by all NPOs. The approach also needs to be adaptable, so that NPOs that wish to go beyond this core can do so provided that the key elements that are important to users of all NPO GPFs have been met. This would ensure a base

level of consistency and comparability amongst all NPOs applying the INPAG, while providing NPOs the freedom to move beyond this to meet the needs of the users of their GPFRs.

- 3.2 A mandatory framework and principles approach to narrative reporting based on the existing IASB Practice Statement and IPSASB Recommended Practice Guidelines (RPGs) is proposed to develop the Exposure Draft on narrative reporting. The use of the IASB Practice Statement and IPSASB RPGs is proposed instead of the <IR> framework as they are expected to be less complicated for NPOs to apply and will complement the information in the financial statements rather than require NPOs to also apply broader integrated reporting principles.
- 3.3 The proposal is for a mandatory core of narrative reporting that covers two main areas. The first is financial statement analysis and commentary. The second is broader performance reporting. The requirements of the IASB Practice Statement and IPSASB RPGs will be tailored to meet the needs of users of NPO GPFRs and to reflect the capacity and capability of the NPOs that the INPAG is initially aimed at. Guidance will also be provided to NPOs to assist them in applying these requirements.

Financial statement analysis and commentary

- 3.4 The IASB Practice Statement and IPSASB RPG 2 provide guidance for preparing and presenting narrative commentary to discuss and analyse an entity's financial statements. Adapted from these frameworks, it is proposed that the INPAG requirements will be developed so that NPOs will need to report on the following elements:

Element	Description of element and examples of information that could be provided
An overview of the NPO's activities and the environment in which it operates.	To enable users to understand the NPO's activities and how the environment in which it operates affects its financial statements. Information provided may include: <ul style="list-style-type: none"> (i) the NPO's mission and vision; (ii) the NPO's governance; (iii) the NPO's relationship with other entities that could significantly affect the NPO's financial position, income and expenditure and cash flows;



	<p>(iv) External trends, events and developments which have or may have a significant impact on the NPO's financial position, income and expenditure and cash flows; and</p> <p>(v) The NPO's main activities, including how it seeks to achieve its objectives and any significant changes to this in the reporting period. This will link to the performance information provided in the narrative report.</p>
<p>Information about the NPO's objectives and strategies.</p>	<p>A discussion of the NPO's objectives and strategies relating to its financial position, income and expenditure, and cash flows in a way that enables users of the financial statements to understand the NPO's priorities and to identify the resources that must be managed to achieve these objectives and strategies.</p> <p>This could include for example information on the NPO's reserve policy, the amount of unrestricted reserves it aims to hold, and how it plans to achieve or maintain this.</p>
<p>An analysis of the NPO's financial statements including significant changes and trends in an entity's financial position, income and expenditure and cash flows.</p>	<p>Discussion and analysis describing the significant items, transactions and events that have affected the financial position, income and expenditure and cash flows, without simply reiterating the information presented in the financial statements.</p> <p>An example of information that could be provided would be a description of the extent incoming resources have been reduced due to a dependency on specific donors that have reduced funding, or major fundraising events that have had a significant positive impact on the extent of reserves available to support day-to-day operations.</p>
<p>A description of the NPO's principal risks and uncertainties that affect its financial position, income and expenditure, and cash flows, an explanation of changes in those risks and</p>	<p>The NPO's principal risks and uncertainties that affect its financial position, income and expenditure and cash flows should be described including an explanation of how this relates to the objectives and strategies of the entity and how these are managed. This information will help users to</p>



<p>uncertainties since the last reporting date and its strategies for bearing or mitigating those risks and uncertainties.</p>	<p>evaluate the impact of those risks in the current period as well as expected outcomes.</p> <p>An example of the information provided could be the risk that dependence on a particular source of revenue has for the level of financial resources available to the NPO and the outcomes and impact that it seeks to achieve.</p>
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Performance reporting

- 3.5 The IPSASB RPG 3 also provides guidance on reporting performance information on service delivery. Adapted from this framework, it is proposed that the INPAG requirements will be developed so that NPOs will need to report on the following elements related to performance:

Element	Description
<p>NPO performance objectives.</p>	<p>Performance objectives will be a description of the planned result(s) that an NPO is aiming to achieve. These may be expressed using performance indicators of inputs, outputs, outcomes, or efficiency; or through a combination of one or more of these four performance indicators. A performance objective may also be expressed using a narrative description of a desired future state resulting from the NPOs operations and activities.</p>
<p>Performance indicators.</p>	<p>Performance indicators may be quantitative measures, qualitative measures, and/or qualitative descriptions of the nature and extent to which an NPO is achieving its performance objectives. It is expected that the NPO will be required to explain how the performance indicators presented have been developed and are used to determine if performance objectives have been met.</p>
<p>Achievement of performance objectives.</p>	<p>The performance information presented should be tailored to the needs of the NPO's users to provide them with an understanding of the extent to which performance objectives have been achieved. This may include integrating this performance information with existing performance reporting that is provided to donors and other stakeholders.</p>

- 3.6 Reporting on these elements could represent the minimum mandatory core of narrative reporting requirements. For NPOs that have the capacity and capability to go further, INPAG could permit the use of other frameworks and existing performance reporting to donors and other stakeholders provided the minimum mandatory core requirement is met. This could include applying the <IR> framework, an alternative which had the highest level of support amongst respondents to Part 2, should NPO's wish to do so. It could also include the application of sustainability reporting frameworks, either as part of how the NPO applies financial statement analysis and performance reporting or as a separate area of the narrative report.
- 3.7 Permitting the use of other frameworks will provide both an opportunity for NPOs to progress in maturity and approach to narrative reporting where this is of benefit to users, and ensure that those already reporting beyond the mandatory requirements can continue to do so.

PAG and focus group feedback on the proposed approach

- 3.8 The proposed approach was presented to the PAG at its March 2022 meeting. There was general support for the direction set out, although there were a number of comments highlighting the need to ensure that the difference between NPOs and the for-profit and public sector was recognised in the proposal. It was suggested that the approach and language used in INPAG may need to be adapted further to make it more sector specific, particularly with respect to performance reporting.
- 3.9 PAG members highlighted jurisdictional-level approaches to performance reporting that should be considered as the proposals are further refined, in particular New Zealand's PBE FRS 48. In accordance with the financial reporting framework hierarchy, these jurisdictional-level standards will be drawn upon where the international frameworks do not provide comprehensive or appropriate guidance in the NPO context as the approach is developed into an Exposure Draft.
- 3.10 PAG members also agreed that guidance and examples of good practice would be needed to support NPOs in applying the approach and that this would also be useful for users in understanding the information that was being provided.
- 3.11 Following the PAG meeting, a focus group on narrative reporting was held in April 2022. Although there was a relatively healthy response to Part 1 of the Consultation Paper with over 50 individual responses, fewer than 30 respondents answered the Specific Matters for Comment on narrative reporting

in Part 2. Additional sector outreach has enabled a broader range of evidence to ascertain whether the proposed approach would meet user needs and provide an effective mandatory core of narrative reporting requirements.

- 3.12 A diverse group of participants discussed the Consultation Paper responses and the proposed approach, providing valuable feedback, which will be used in further refining the proposals and the accompanying guidance. There was agreement on the need to ensure financial statement analysis and performance reporting were integrated, although some caution on the burden this could impose on NPOs in addition to existing donor reporting.
- 3.13 Additional frameworks that could potentially be useful for narrative reporting were also highlighted, including the OECD's DAC criteria and FATF Standards. These frameworks will be reviewed to determine the extent to which they can provide useful principles for the narrative reporting guidance.

- **Question 1:** Do the TAG support the proposed approach to developing a mandatory core of narrative reporting requirements based on existing IASB and IPSASB guidance?

4. Specific reporting requirements

- 4.1 Both the PAG and the focus group were also asked if there were any additional specific reporting requirements that should be included in the mandatory core of reporting.
- 4.2 Sustainability reporting in particular was mentioned, but it was felt premature to require this as a mandatory component of narrative reporting. This was because current developments appear to be aimed primarily at the needs of the private sector and private sector users. The proposed approach would, however, permit NPOs to apply sustainability reporting frameworks. As developments in this area and their impact on broader reporting requirements are expected to become increasingly important these will need to be monitored.



- Question 2: Are there any specific reporting requirements that the TAG consider should be included beyond the financial statement analysis and commentary and performance reporting in the proposed approach?

5. Next Steps

- 5.1 On the basis of the feedback received on these proposals, the Exposure Draft text of the INPAG for Narrative Reporting will be developed and presented to the TAG at its June 2022 meeting for comment.
- 5.2 Further work will also be undertaken to develop supporting material for applying narrative reporting requirements, with a view to present final Exposure Draft proposals to the TAG in September 2022.

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INTERNATIONAL FINANCIAL REPORTING
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Annex A: Consultation Paper Part 2 Responses