PART 1: General NPO financial reporting issues

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INTERNATIONAL FINANCIAL REPORTING
FOR NON PROFIT ORGANISATIONS

Chapter 1: What are non-profit organisations?

Chapter 1: What are non-profit organisations?

1.1. The IFR4NPO Project has been established to develop financial reporting guidance for non-profit organisations (NPOs). This chapter looks at what is meant by the term 'NPOs', and as a result which organisations' financial reports might be addressed by the project's first objective:

> **Objective 1:** To improve the quality, transparency, and credibility of NPO financial reports.

1.2 It proposes a broad characteristics approach to describing the entities that the IFR4NPO Project Guidance is expected to primarily benefit.

Broad characteristics approach to describing non-profit organisations

1.3 There is a diverse range of organisations that can potentially be considered as NPOs and which could benefit from the Guidance being developed. NPOs range from small community bodies to large international aid organisations. They vary significantly in how they are funded, with sources ranging from public donation, grants and bequests, to significant commercial trading revenue streams. The geographic scope of their operations is also diverse, varying from a defined local area to an entire jurisdiction, with some even having a global reach.

1.4 The services delivered by these different organisations are also varied. They include a wide range of activities such as health and social services, education and research, environmental protection, development, aid, advocacy, religion, culture and recreation.

1.5 As well as diversity in funding, service delivery, and scope of operations, there is also diversity in the legal and regulatory environments within which NPOs operate. In some jurisdictions, organisations with non-profit characteristics are given special legal and taxation status and may be subject to specific financial reporting requirements and/or guidance. In other jurisdictions no such formal recognition exists, and such organisations are treated in a similar manner to for-profit entities.

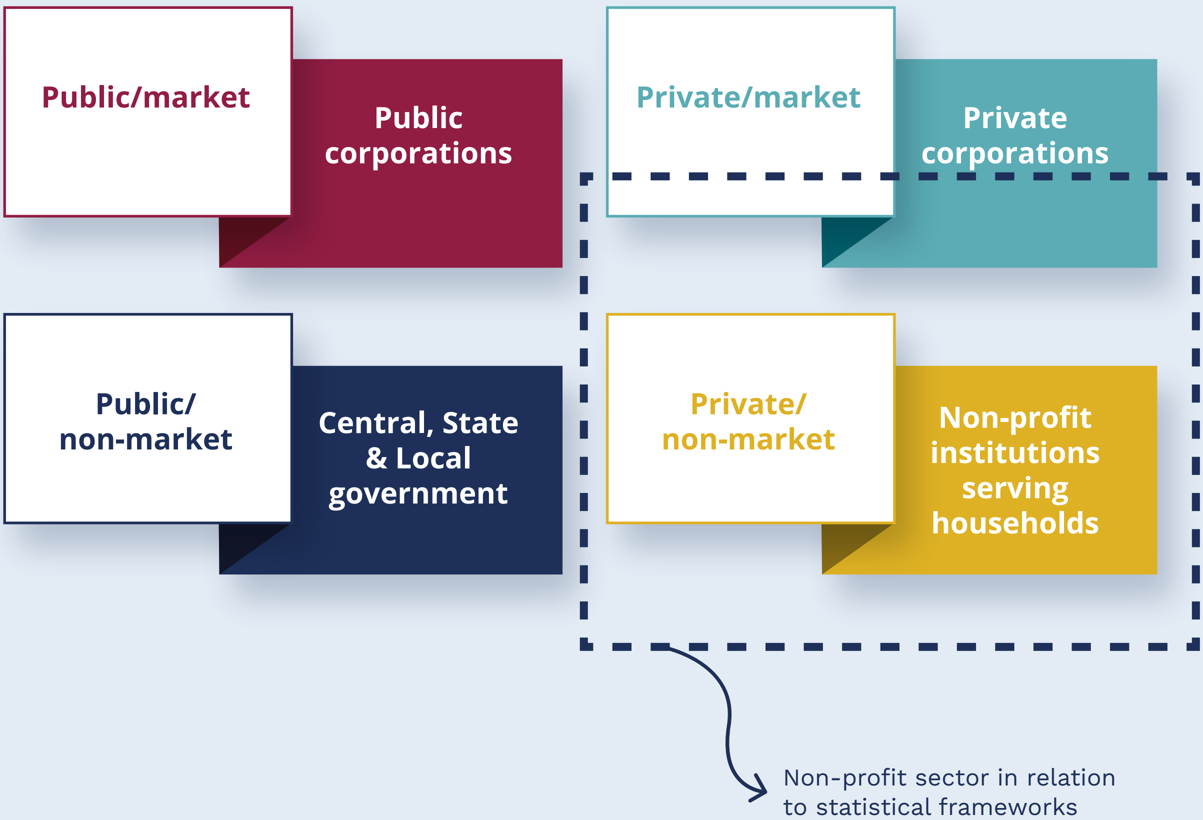
1.6 Consideration of NPO financial reporting issues and the development of the Guidance requires a common understanding of what is meant when the term 'NPO' is used. With this huge degree of diversity there is a risk that any attempt to describe NPOs may unintentionally exclude entities that might benefit from the Guidance being developed.

1.7 There are various existing approaches to classifying sectors of the economy that the IFR4NPO project could draw on to reduce this risk of exclusion.[9] The work of the organisations that have developed these approaches (which includes for global economic statistics) provides a good platform on which to build.

1.8 To enable the production of economic statistics, the key considerations in the existing frameworks include whether an organisation is under private or public/government control, and the extent to which the organisation charges market prices for the goods and services it produces. This results in four broad sectors of the economy and organisations within them.

1.9 A wider range of organisations other than just non-profit institutions serving households can however have non-profit characteristics, and so could be described as NPOs. For example, there are private organisations that charge a market price for the goods and services they produce but reinvest any surpluses to furthering service delivery objectives. They do not aim to provide financial returns to investors and as such could also be categorised as NPOs. This is highlighted in Figure 1.1, with the dotted line showing that NPOs can extend beyond the definition under statistical frameworks.

Figure 1.1: Economic sectors and types of organisations



[9] For examples of existing international classification frameworks and jurisdictional-level approaches to defining NPOs for financial reporting guidance, see the Supplementary Information: Additional project information.

1.10 Statistical frameworks have rules rather than being entirely principles-based, so from a financial reporting perspective there are some issues with utilising them directly. These rules, for example, exclude an organisation from being categorised as an NPO if it is not independent of government, whereas some jurisdictions find it useful to permit some public sector entities to be defined as NPOs for financial reporting purposes. To use existing statistical frameworks on their own would therefore result in less focus on some of the important sector specific key economic events and transactions relevant to NPOs on which the IFR4NPO project aims to provide principle-based financial reporting guidance.

1.11 Instead of applying an existing framework directly to define NPOs for the purpose of the Guidance, the project is proposing to take a broad characteristics approach to describing which organisations might be NPOs. This approach would use the structural and operational features of NPOs identified in existing frameworks, which could provide a useful start point. The broad characteristics approach would then supplement them to provide a greater focus on the key economic events and transactions relevant to the non-profit sector.

1.12 While it is expected that many NPOs will display all of these broad characteristics to a greater or lesser extent, they are intended as indicators of an organisation being an NPO, rather than a set of rules. Therefore, an organisation would not need to demonstrate all characteristics to be considered an NPO for financial reporting purposes. It could have strong alignment with some characteristics and none with the others. For example, some NPOs fund themselves entirely through the sale of goods and services but direct all profits to furthering public benefit objectives. In this example NPOs are expected to benefit from the Guidance but may find some aspects less relevant.

Figure 1.2: Broad characteristics of NPOs

Delivering services for public benefit

The primary objective of an NPO is to deliver services to the general public, community or for social benefit and not to generate a financial return for providers of resources.

Profits/ surpluses are directed for public benefit

NPOs may generate a financial surplus, particularly where they receive income from the sale of goods and services, but this will be directed to furthering the entity's primary public benefit objectives and not distributed to providers of resources.

Voluntary donations and grant funding may be significant

Voluntary funding through donation, grant, or volunteering of time may be significant to the entity, but the provision of such funding is not compulsory and the provider may impose restrictions or conditions that limit how it can be used.

Assets are held and used for social purposes

NPOs may control or have access to assets such as buildings or equipment that are used as part of their operations, but these assets will be held primarily to assist in delivering services for social benefit and not to generate a financial return.

1.13 As will be developed in Chapter 2, the Guidance is intended to assist in providing solutions to issues with current accountability arrangements and the provision of decision-useful information. Jurisdictions and funders may find the Guidance useful in improving the accountability and decision-making arrangements of NPOs who account for similar economic events and transactions in order to improve accountability and decision-making arrangements. The adoption of the Guidance in whole or in part by NPOs will be subject to decisions by individual jurisdictions and the requirements of funders.

Conclusion to Chapter 1: What are non-profit organisations?

1.14 A broad characteristics approach has been developed to describe the types of organisations that are likely to benefit the most from this Guidance. They 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.

1.15 By adopting this broad description, the project in delivering its objectives can focus on proposals that best meet the needs of the organisations with some or all of these characteristics.

1.16 Chapter 2 examines the main stakeholders of NPOs, problems with current accountability arrangements, the provision of decision-useful information, and the implications of this for the development of internationally applicable financial reporting guidance for NPOs.

General Matters for Comment 1

Chapter 1 has outlined a broad characteristics approach to describing NPOs for developing the Guidance:

1.a Do you agree with the broad characteristics proposed in Chapter 1 for describing NPOs? If not, why not? Which alternative characteristics would you propose, and why?

INTERNATIONAL FINANCIAL REPORTING
FOR NON PROFIT ORGANISATIONS

Chapter 2: Who are NPO stakeholders and what are their needs?

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2.1 Chapter 1 described the organisations that are likely to benefit from using the Guidance by focusing on broad characteristics. Describing what makes NPOs different to other types of organisation, both from a structural and operational perspective and with respect to key economic events and transactions, provides a focus for the project, which will support the achievement of Objective 1.

> **Objective 1:** To improve the quality, transparency and credibility of NPO financial reports.

2.2 Objective 2 addresses the information needs of NPO stakeholders and users of NPO financial reports. Achieving this objective requires an understanding of the arrangements that support accountability and decision making in the non-profit sector.

> **Objective 2:** To support the provision of NPO financial information that is useful for decision making and accountability, balancing the needs of preparers and users.

2.3 This chapter focuses on the accountability and decision-making arrangements that are most relevant to the external stakeholders to which NPOs are accountable. This includes the high-level information needs of these stakeholders, and their more specific information needs as users of an NPO's financial information. Problems with existing arrangements driven by different jurisdiction and donor reporting requirements are also highlighted.

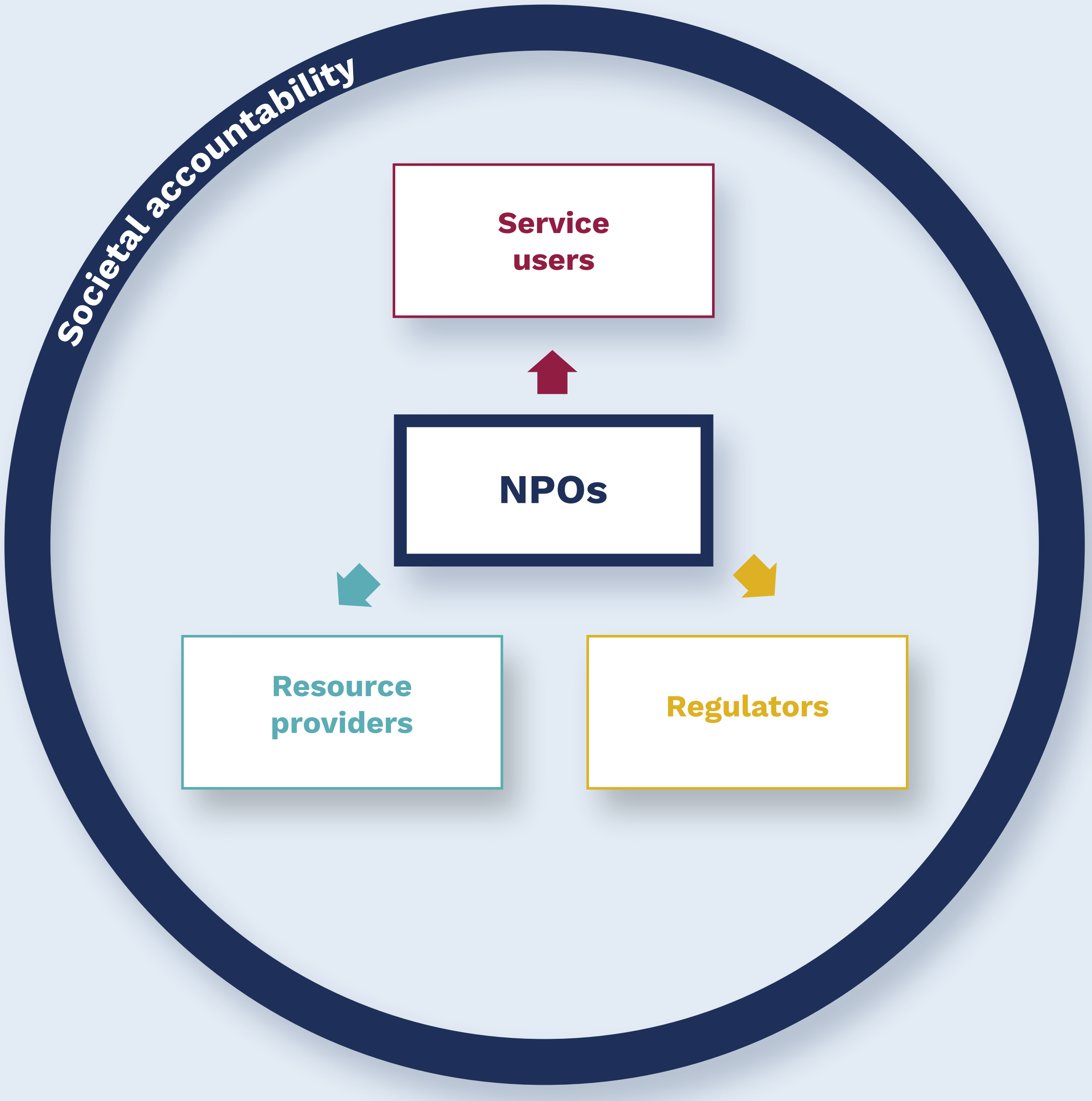
Which external stakeholders are NPOs accountable to?

2.4 Accountability arises when decisions and actions are undertaken by those in a position of responsibility. Accountability entails accepting responsibility for those decisions and actions, together with a requirement to explain them to external stakeholders, be they individuals or entities.

2.5 The external stakeholders to whom NPOs are accountable make decisions based on the information provided to them. This could include requests from service users that the entity provide additional or different services, decisions by funders to increase or reduce financial support to projects and programmes being delivered by an entity, or decisions by regulators about whether to continue to provide benefits associated with NPO status.

2.6 The broad characteristics of NPOs identified in Chapter 1: Figure 1.2 are useful in understanding the different needs of the broad groups of external stakeholders to whom NPOs may be accountable, illustrated in Figure 2.1.

Figure 2.1. External stakeholder NPO accountability relationships



Service users

2.7 The primary objectives of NPOs are to deliver services for public benefit. These services can include a wide range of activities such as health and social services, education and research, environmental protection, development, aid, advocacy, religion, culture and recreation.

2.8 Service users are those that benefit directly or indirectly from an NPO's activities. They may also commonly be referred to as service recipients, beneficiaries, or clients. The diversity of services provided by NPOs means that their service users are also diverse. They can range from the entire population in a jurisdiction, to a small subset of a community, or may even be limited to only the members of an NPO.

Resource providers

2.9 NPOs often receive donations, grants and funding from other sources. These resources are provided voluntarily to advance the NPO's public benefit objectives without an expectation of a financial return or any direct benefit being returned to the resource provider. Such voluntary resources are often financially significant to an NPO. They can include monetary contributions from the general public, corporate entities, government aid agencies, funding organisations and philanthropic bodies. They may also be non-monetary, such as donated services (for example volunteers providing free labour and services) or goods (for example donated inventory and other assets).

2.10 Banks, lenders and other similar bodies will also provide financial resources and other support to NPOs and will seek to ensure that NPOs are complying with requirements they have set in exchange for providing that support.

Regulators

2.11 NPOs may receive financial and other privileges by jurisdiction governments to support them in the achievement of their objectives. Regulators ensure NPOs are complying with the legal and regulatory requirements such as delivering services for the public benefit and not solely for private profit as part of these arrangements. The term 'regulators' can include governments, specially established regulatory bodies and other similar organisations.

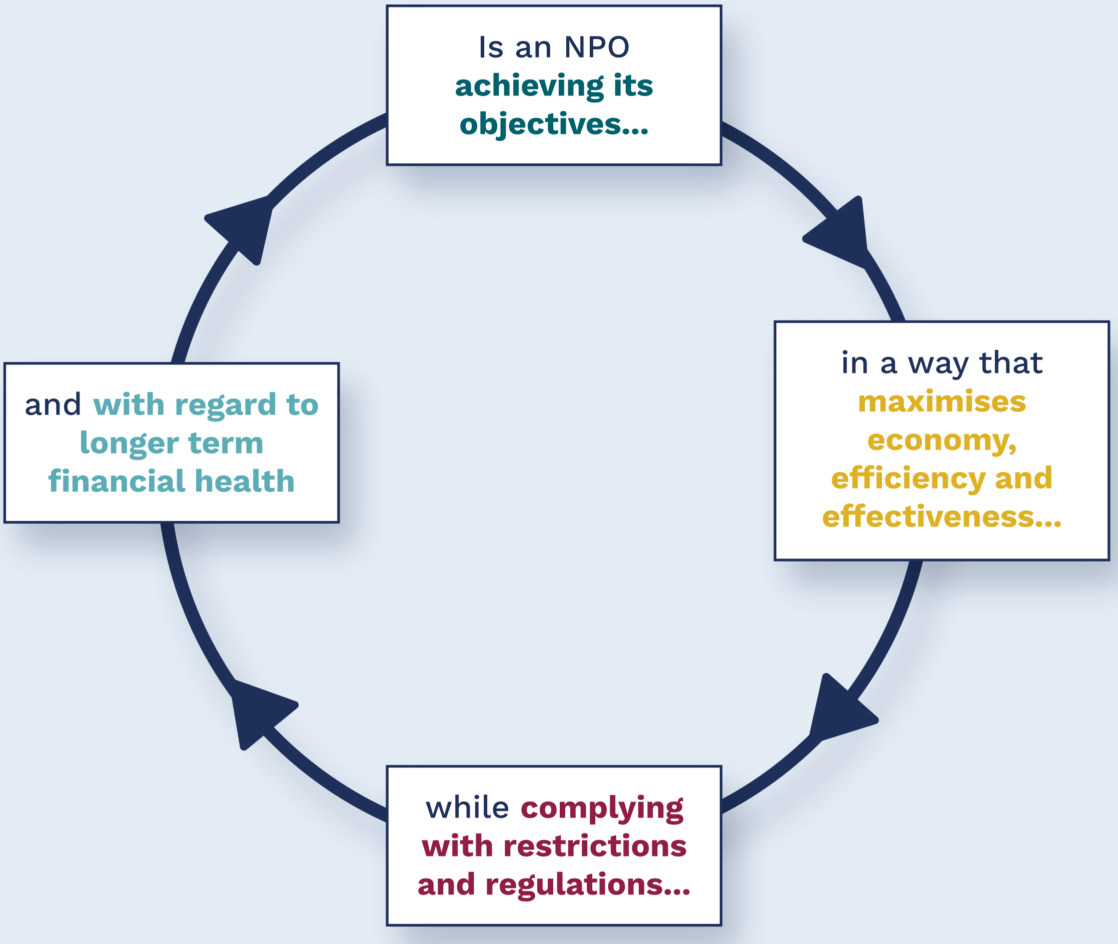
Societal accountability

2.12 The large number of stakeholders to whom NPOs can be accountable can give rise to a wider societal accountability. This is an expansive view of accountability that recognises a general accountability to society at large. This is due to the importance of NPO services, the funding environment, the preferential treatment that NPOs can receive compared to other organisations, and the need to ensure the effective operation of the wider sector. It requires transparency, with information available to society as a whole. This notion of a broader accountability is not unique to NPOs and is explained further in Supplementary Information: Additional project information.

What information do NPO external stakeholders need for accountability and decision-making purposes?

2.13 Accountability involves the provision of relevant information to external stakeholders by an organisation. Decision-making involves those external stakeholders determining a course of action based on the information provided and the options available. Service users, resource providers, and government, regulatory and similar bodies share some common high-level information needs for accountability and decision-making purposes, even though these arise from different perspectives.

Figure 2.2 Common high-level information needs of external stakeholders



2.14 External stakeholders need to know if an NPO is **achieving its objectives**. The primary objective of an NPO is to deliver services for the public benefit, and an NPO needs to demonstrate that resources have been used to deliver services of sufficient quality for service users. If an NPO cannot demonstrate that it is achieving its objectives resource providers may reduce or withdraw the funding they provide to an NPO, or regulatory bodies may decide to withdraw privileges provided to the organisation.

2.15 An NPO also needs to demonstrate that these services have been delivered in a way that **maximises economy, efficiency and effectiveness** in the use of resources. This will entail securing inputs of sufficient quality at appropriate cost, and investment in the appropriate amount of administration infrastructure to ensure optimal service delivery. An inefficient NPO is likely to face pressure from service users and funders to improve its operations and direct resources more effectively to service delivery.

2.16 External stakeholders will also require information to show that an NPO is **complying with restrictions and regulations.** Resources are often provided for specific purposes by donors, who will need assurance that they have been used only for these purposes, otherwise they may require the resources to be returned to them. Government, regulatory and other similar bodies will need confirmation that an NPO is complying with broader regulations in areas such as operations, governance, purchasing and financing. Without this confirmation, these bodies may revoke regulatory or financial privileges afforded to an NPO.

2.17 Finally, an NPO will need to show what is being achieved **in the context of its longer-term financial health.** External stakeholders will want to know that an NPO can continue achieving its objectives, especially if they are utilising an NPO's services or providing financial resources to it. An NPO will, therefore, need to provide external stakeholders with information on the sustainability of its levels of reserves, demonstrate that it has reliable funding sources, and that it has the resources required to meet both current and future costs related to expected levels of activity.

2.18 In meeting these needs, information provided to stakeholders will need to be understandable, relevant, reliable and comparable.

Drivers of diversity in current financial reporting for accountability and decision-making purposes

2.19 Stakeholder high-level information needs to cover a wide range of management and performance information related to an NPO and its activities. Some external stakeholder groups will primarily be interested in an NPO's financial information and can be referred to as users of an NPO's financial information and reports. Their information needs as users of an

NPO's financial information will be more specific, with a greater focus on key financial indicators such as revenue and expenses, and how resources have been utilised on individual programmes.

2.20 The Guidance developed by the IFR4NPO project will assist in meeting the high-level information needs of most stakeholders. Its primary focus, however, will be on meeting the accountability and decision-making needs of users of NPOs' financial information and reports.

2.21 Existing financial accountability arrangements implemented by NPOs to meet user needs, and permit decision-making differ significantly globally. This is primarily a result of the different reporting requirements set by individual jurisdictions, but donor reporting requirements also vary significantly, and drive diversity.

Jurisdictional-level reporting requirements

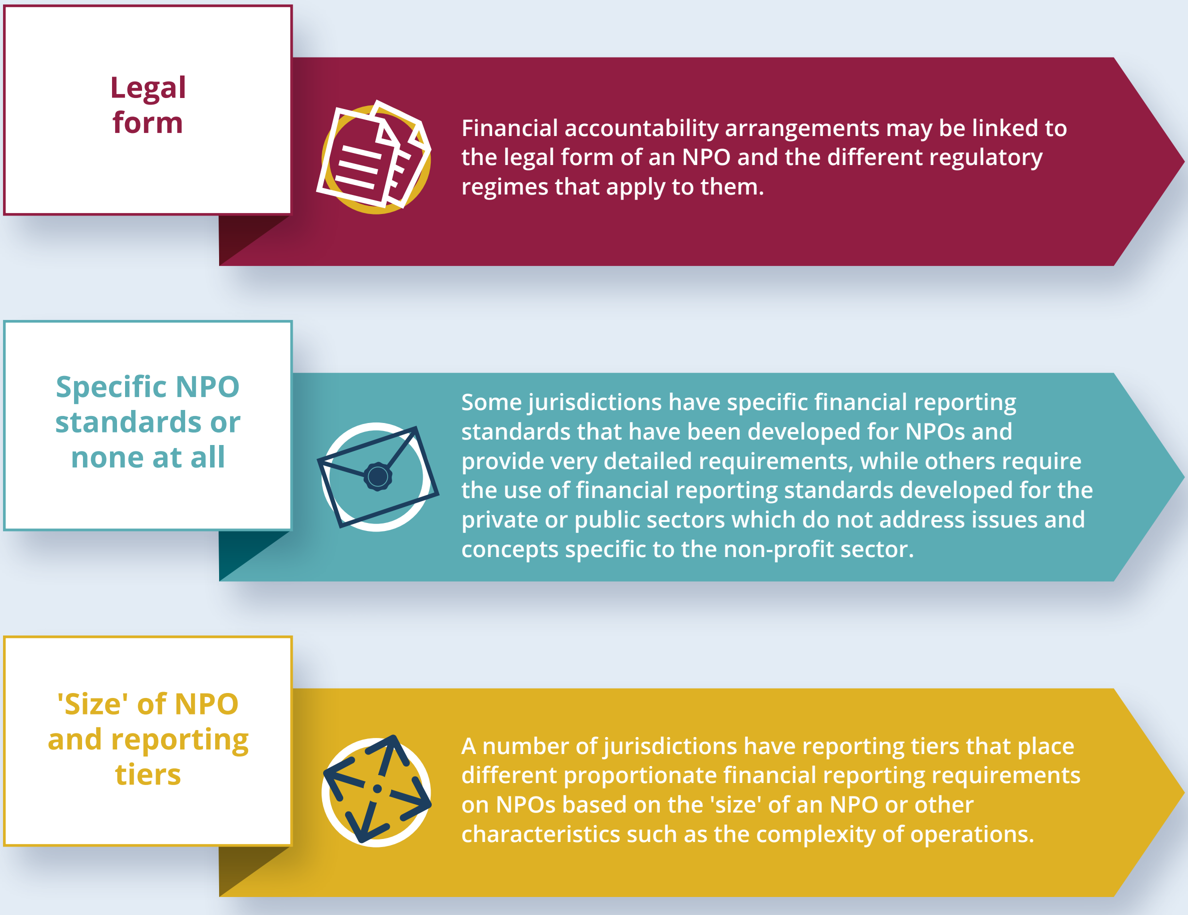
2.22 NPOs are often required to submit formal financial information to jurisdictional authorities to comply with local taxation and other regulatory requirements. Where an NPO operates across borders it may be required to submit accounts in multiple jurisdictions. The applicable standards, format and content required can vary by jurisdiction. This diversity in financial accountability arrangements is driven by a number of factors as shown in Figure 2.3.

2.23 At a jurisdictional level, the consequences of this diversity include:

- An NPO operating in one jurisdiction may face significantly different reporting requirements to a similar NPO operating in another jurisdiction.
- An NPO operating in a single jurisdiction may face significantly different reporting requirements to an NPO operating in the same jurisdiction that has a different legal form or is judged to be in a different reporting 'tier'.
- NPOs that are registered in and/or operate in more than one jurisdiction may be required to comply with a number of different reporting regimes.

2.24 Individual jurisdictions make decisions on reporting requirements for NPOs based on characteristics such as legal form and with a view to ensuring proportionality. The IFR4NPO project can provide common financial reporting standards that address the issues and concepts specific to NPOs. This can support a reduction in diversity across jurisdictions.

Figure 2.3: Drivers of diversity in jurisdictional-level financial reporting requirements



Donor reporting arrangements

2.25 In contrast to jurisdictional requirements, donors are more likely to require NPOs to provide financial reports to demonstrate how resources have been utilised on individual projects and programmes they support. In the absence of common NPO reporting requirements these will be requested to meet their individual standards, formats and reporting periods. While individual project reports may continue to be required by donors, the Guidance can assist by establishing a consistent basis for these reports.

2.26 Many NPOs are increasingly operating in a global funding environment, and this is leading to a multiplicity of international grant and funding regimes. These grant and funding regimes bring with them a variety of accountability and decision-making arrangements, particularly with respect to how NPOs account for and report on the use of financial and other resources provided by donors.

2.27 As accounting and financial reporting arrangements for NPOs can vary significantly both between and within jurisdictions, it is difficult for those providing funding to NPOs to use and interpret the financial reports that NPOs prepare under these different arrangements. This may restrict the ability of donors to use these reports as part of the process to gain assurance that funding has been used in an economic and efficient way towards the purposes for which it has been provided. It also undermines the ability of donors to use these financial reports to compare the performance of different NPOs and ensure that their financial resources are directed to those entities which are most effectively achieving their objectives.

2.28 This is one factor behind the development by large donors in particular of their own financial reporting requirements. These have been developed independently by aid agencies and some philanthropic organisations primarily to meet their own accountability and decision-making requirements.[10] Compliance with these by an NPO is usually a condition of the funding. An NPO that receives resources from multiple sources will therefore most likely have multiple differing donor reporting requirements.

2.29 The risk for an NPO with multiple donors is that there is a significant burden to producing financial reports for each donor, as well as meeting other financial and regulatory reporting required by individual jurisdictions. This can result in fewer resources being available for service delivery and increase the risk of

[10] It must be recognised that donors themselves will be accountable to either the public or other stakeholders for the use of funds, including that resources provided to NPOs have been used in a proper manner. As such, detailed information on the use of funding may be sought not just to ensure that the funds provided have been spent on an individual project or programme. There may also be a need to demonstrate compliance with wider corporate governance and procurement standards for the donor, in order to give assurance to its stakeholders that funds have not been misused, or there is no potential for misuse.

reporting errors as NPOs look to meet the differing reporting requirements to which they are subject. There is also the risk that by focusing reporting on financial reports for donors, the needs of other external stakeholders and the broader requirements of societal accountability are not met.

2.30 While it is expected that donors will still in many cases continue to require NPOs to report directly to them, the IFR4NPO project can support a reduction in the reporting burden on NPOs. The use of common financial reporting standards will enable donors to make greater use of reports NPOs are producing for financial reporting and other regulatory purposes. It may also reduce the diversity in the different donor reporting requirements placed on NPOs if they can adopt these common standards.

Conclusion to Chapter 2: Who are NPO stakeholders and what are their needs?

2.31 This chapter has looked at NPO stakeholders and their accountability and decision-making requirements. 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.

2.32 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.

2.33 This chapter provides important context that needs to be reflected in the development of a solution that improves financial reporting as anticipated in objective 1 and meets the needs of preparers and stakeholders as set out in objective 2.

General Matters for Comment 2

Chapter 2 has examined NPO external stakeholders, what information those external stakeholders need for accountability and decision-making purposes, and issues with current arrangements.

2.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?

2.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?

2.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?

Chapter 3: What are the essential aspects of NPO financial reporting guidance?

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3.1 Financial reporting frameworks are based on concepts that are aligned to their overall objectives. Concepts underpin the standards and other guidance within financial reporting frameworks to provide coherence. Similarly, NPO financial reporting Guidance needs to be developed using core premises aligned with the objectives of the Guidance:

Objective 1: To improve the quality, transparency and credibility of NPO financial reports.

Objective 2: To support the provision of NPO financial information that is useful for decision making and accountability, balancing the needs of preparers and users.

Objective 3: To address specific NPO issues, which will promote increased comparability of NPO financial reports.

3.2 Chapter 2 provided an overview of the high-level information needs of stakeholders and users of an NPO's financial information. These included requirements such as understanding the extent to which an organisation is achieving its objectives, abiding by regulations and restrictions, and has longer-term financial sustainability. This chapter explains the rationale for two core premises proposed for the development of NPO financial reporting guidance that are essential to meeting these stakeholder and user needs and the three Guidance objectives. These are:

- **accrual-based accounting** – which is internationally recognised as the best basis to provide a comprehensive view of an organisation's financial performance and position, improving the quality and transparency of financial reports and enhancing accountability and decision-making and
- **the inclusion of non-financial reporting information** – in order to provide context to financial information and additional information about the organisation's projects, programmes and wider activities required to meet broader stakeholder information needs.

The following sections discuss each premise and explain why they are necessary to meet the project objectives.

3.3 This chapter also describes common forms of financial reports used to demonstrate accountability and enable decision-making.

Accrual-based accounts

3.4 The basis of accounting is the method used to determine when economic events and transactions are recognised in the financial reports. The Guidance needs to have a single basis of accounting, so that financial reports are prepared on a consistent basis. There are three bases of accounting that are commonly used:

- **Cash[11]** – economic events and transactions are recognised when cash is received or paid. Assets and liabilities are not recognised.
- **Accrual** – economic events and transactions are recognised when the event occurs. This is when, for example, a service is provided and not when any related cash payments are made. Assets and liabilities are recognised.
- **Modified cash** – some economic events and transactions are recognised on a cash basis, but others may be recognised on an accrual basis. Some assets and liabilities may be recognised.

3.5 Each of these bases of accounting have advantages and disadvantages. Here additional information on their key features is provided before examining how they meet the objectives of the Guidance.

Cash basis accounting

3.6 Maintaining cashbooks for different bank, mobile money, and other cash accounts is the essential bedrock for all accounting. Cash accounting records transactions at the point when money is received and paid by an entity. Financial reports produced under cash accounting are usually a cashbook summary, often called a receipts and payments report. This shows the opening cash/bank balance, receipts by category, payments by category, and the closing cash/bank balance. Information on a cash basis at an individual programme or project level is often requested by donors and other stakeholders to understand how resources provided have been spent.

3.7 All organisations require effective controls over and accurate accounting for cash. Where financial reporting is based solely on cash, however, it is not possible to have a comprehensive view of the organisation's financial performance and position. Until a bill is paid for example, it will not show as an expense in the accounts. This impacts transparency, accountability and the decision-usefulness of cash-based financial reports.

[11] Note that cash does not just mean physical currency including notes and coins but also receipts and payments into entity bank or mobile money accounts as well.

Accrual basis accounting

3.8 Accrual accounting requires transactions and other economic events to be recorded when they occur as well as the recognition of assets and liabilities. This means that income and expenses are recorded when they are earned, when a service has been performed, or when a good has been provided – and not just when cash is received or paid. Accrual accounting also requires that money spent on assets like vehicles or buildings that will be used for many years is not included as a one-time expense, but instead the expense recognised over time to match the use of the asset. Other items that are not captured under cash accounting such as receivables (money the entity is owed) and payables (money the entity owes) are also recognised in the financial statements.

3.9 The extra financial information provided by accrual accounting processes means that as well as a statement that shows cash movements, there are additional financial reporting outputs. These include:

- a statement of financial performance (also known as an income and expense statement, profit and loss, or statement of financial activities) which shows revenue and expenses
- a statement of financial position (also known as a balance sheet) that shows what an entity owns and what it owes.

3.10 These additional financial reporting outputs provide a comprehensive view of an organisation's financial performance and position. Transparency over the nature of costs and revenues, the assets over which the organisation has stewardship and that it relies on to deliver services, and the amounts it owes that need to be met from existing and future resources available to it, enhances accountability and decision-making.

Modified cash basis accounting

3.11 In between cash accounting and accrual accounting is the modified cash basis of accounting, where some transactions are recognised on a cash basis and some on an accrual basis. There is no single definition or generally accepted framework for the modified cash approach. It can take many different forms, with different decisions made about what is recognised on a cash basis and what is recognised on an accrual basis.

What is the appropriate basis for the Guidance?

3.12 Examining cash, accrual and modified cash accounting against the objectives of the Guidance, it is clear that for most entities, accrual has the greatest advantages and the least significant disadvantages.

Figure 3.1 Comparison of the different bases of accounts against the project objectives

	Cash basis	Accrual basis	Modified cash basis
Objective 1: To improve the quality, transparency, and credibility of NPO financial reports.	**Advantages**		
	• Easy to track receipts and payments related to individual projects or programmes. • Easiest basis of accounting for users to understand.	• Provides a comprehensive view of an entity's financial position and performance. • Information on the nature of costs, future payments, and resources due. • Can improve quality, reliability and integrity of financial information.	• Maintains easy to track elements of cash and adds understanding of some assets and liabilities.
	Disadvantages		
	• Cannot provide information on overall financial performance and position.	• Needs access to technical accounting capacity and software if transactions are complex. • Users need to understand the information being provided.	• Incomplete picture of financial position and performance. • Lack of consistency in reporting.
Objective 2: To support the provision of NPO financial information that is useful for decision making and accountability, balancing the needs of preparers and users.	**Advantages**		
	• May be preferred by donors most interested in tracking funding for specific projects and programmes. • Can be sufficient for less complex organisations, which do not have significant assets or liabilities. • Usually less resource intensive to produce.	• Knowledge of what is owned, asset condition and how assets are used. • Better management of cash with visibility of the commitments from past events. • Better able to hold management to account and make informed funding and other decisions.	• Can improve the information provided on assets and liabilities depending on which are recognised.
	Disadvantages		
	• Less able, and potentially less incentive, to manage assets and liabilities. • May prevent the formation of a long-term view of the entity's financial viability.	• Can be more resource intensive to produce financial reports. • Additional information is useful only if understood by stakeholders.	• Creates an incomplete picture of financial position and performance, which may impact on the operational and financial decisions.
Objective 3: To address specific NPO issues, which will promote the comparability of NPO financial reports.	**Advantages**		
	• Can accommodate some individual specific stakeholder needs.	• Can address all key NPO-specific issues. • Improve comparability by requiring recognition of all relevant transactions and economic events.	• Some NPO-specific issues may be addressed depending on which assets and liabilities are recognised.
	Disadvantages		
	• Will not address all key NPO-specific issues. • Comparability harmed as timing is likely to lead to differences in financial reports.	• Options for different treatments permitted in accounting standards can reduce comparability between entities. • Requires increased use of judgement, which can increase compliance costs.	• Will not address all key NPO-specific issues. • Comparability harmed as not all accrual information in financial reports.

3.13 Figure 3.1 shows that the additional information accrual accounting can provide improves the quality and transparency of financial reports. Accrual accounting is also best able to address NPO-specific issues and improve comparability. This recognises the balance between the cost of producing accrual-based financial information and the significant benefits to the users of this information for accountability and decision-making purposes. To meet the needs of external stakeholders and users and deliver the project objectives, the use of accrual is therefore the most appropriate basis for common financial reporting. This is therefore the first core premise.

3.14 For less complex NPOs, the cash or modified cash basis and primarily cash-based accountability and decision-making arrangements may be appropriate to meet the needs of external stakeholders. For such entities, the disadvantages of accrual accounting such as the extra resources required to produce accrual based financial reports can outweigh the benefits of the additional information provided.

3.15 It is also recognised that cash and modified cash-based information may continue to be required by large donors to understand the utilisation of funding provided for specific projects or programmes. Increasing the confidence of this stakeholder group in using accrual based financial reports where these can support the meeting of their needs will be important if the reporting burden on NPOs is to be lessened.

Non-financial reporting information

3.16 Management commentary and forms of other narrative reporting that comprise non-financial reporting information are also important for demonstrating accountability and providing decision-useful information. Such reporting encompasses additional information that is provided to supplement and complement the financial statement information. This might include areas such as an entity’s nature, objectives, strategy, risks, and the impact of the entity’s projects, programmes and wider activities.

3.17 Non-financial information is arguably as relevant, if not more so, for NPOs than for other organisations. Providing a wide range of non-financial information and measures helps stakeholders improve their understanding of an NPO and its performance in relation to its primary objectives. Where service delivery for public benefit is so important, this information could provide a clearer indication of how well an NPO is achieving these non-financial objectives. It could also provide stakeholders with information on areas such as the use and importance of volunteer contributions of time that may not be captured in the financial statements alone but upon which an NPO is reliant.

3.18 Currently, requirements to include non-financial information in NPO financial reports vary within and between jurisdictions, with disclosure requirements based on local accounting, regulatory, and legislative requirements. Some jurisdictions have no requirement for non-financial information.

3.19 There can be valid reasons for these differences. Differential non-financial information reporting requirements could, for example, reflect the greater degree of accountability to society and stewardship reporting required of larger NPOs, compared with the more local accountability needs of smaller, community based or similar NPOs.

3.20 In general, however, a lack of consistency in reporting requirements can lead to external stakeholders not having access to the information they require, and difficulties in comparing the performance of NPOs that are subject to different reporting regimes.

3.21 Consistency in the requirement to include non-financial information would benefit stakeholders by providing additional information that might be useful for accountability and decision-making purposes. For users of NPO financial reports, it would deliver transparency and improve credibility, and allow comparison between NPOs. For these reasons, the inclusion within the Guidance of principles related to non-financial reporting information is the second core premise.

What are the different types of financial report that NPOs may produce?

3.22 There are three main approaches to providing reports to external stakeholders to demonstrate accountability and enable decision-making.

Special purpose financial reports

3.23 The term ‘special purpose financial reports’ includes any form of financial statement or financial report that is produced to meet the specific needs and requirements of an individual external stakeholder. They are produced in accordance with standards, formats and reporting periods and currencies set by the external stakeholder. In the context of NPOs they usually provide financial information on individual projects and programmes, rather than for the entity as a whole.

3.24 As each special purpose financial report is produced in accordance with the requestor’s requirements, they can be resource intensive to produce. This can demand significant resources when an entity has many external stakeholders with varying individual requirements.

General Purpose Financial Statements

3.25 General Purpose Financial Statements comprise a single financial report, including a number of defined financial statements produced using a common set of standards, usually on an annual financial year basis. They provide external stakeholders who are unable to require the production of special purpose financial reports with information about what an entity owns and owes, its income and expenses, and how it is financed. They are often used for regulatory purposes.

3.26 The standards used in producing General Purpose Financial Statements are usually set by the authorities in the jurisdiction in which the entity is based. Jurisdictions are likely to have their own standards, formats and reporting periods. Where an entity operates in more than one jurisdiction it may have to produce more than one set of General Purpose Financial Statements. Producing these reports may be less resource intensive where they reduce the need to produce financial reports for specific stakeholders.

General Purpose Financial Reports

3.27 General Purpose Financial Reports are often called ‘annual reports’, and present management commentary and other narrative reporting alongside the financial information contained in the General Purpose Financial Statements. They are intended to provide users with a more meaningful understanding of an entity’s nature, objectives, strategy, risks, and performance. When used effectively, management commentary and other narrative reporting provide a range of performance measures and indicators consistent with underlying financial information. This can provide a clearer view of the impact of the entity’s projects, programmes and wider activities on stakeholders. Further information is in Figure 3.2.

Figure 3.2 Advantages of General Purpose Financial Reports

The objective of general purpose financial reporting is to provide information that is useful for accountability and decision-making purposes to those users who do not possess the authority to require an entity to prepare and disclose information to meet their specific needs.

General Purpose Financial Reports are therefore intended to provide a single annual report that includes audited financial information to meet the greatest common needs of the key users of that financial information.

In the private sector, General Purpose Financial Reports are aimed at meeting the needs of investors. In the public sector, General Purpose Financial Reports are aimed at meeting the needs of citizens (as both service users and taxpayers) and the government, and for the non-profit sector General Purpose Financial Reports should meet the needs of relevant stakeholders as set out in Chapter 2.

General Purpose Financial Reports are more comprehensive than General Purpose Financial Statements. General Purpose Financial Statements comprise the balance sheet, income statement, statement of changes in equity, and cash flow statement and provide information about an entity's assets, liabilities, equity, income and expenses that is useful to financial statement users when assessing prospects for future net cash inflows to the entity and management's stewardship of the entity's resources.

General Purpose Financial Reports include not only the General Purpose Financial Statements but also non-financial information, so providing users with integrated information that provides context for the financial statements and complements and supplements them through discussion of issues, such as:

- the nature of the entity's business
- its objectives and strategies
- resources, risks and relationships
- results and future prospects
- the performance measures and indicators used to manage the business.

3.28 Producing General Purpose Financial Reports significantly improves the usefulness of the financial and non-financial information provided to external stakeholders. General Purpose Financial Reports have the potential to reduce funders' demand for Special Purpose Financial Reports, enabling NPOs to demonstrate accountability while reducing the burden of having to report to external stakeholders in different formats and to different standards. They can also enable those external stakeholders to make decisions by being able to compare the financial and non-financial performance of the entity over time and against other entities more easily.

3.29 As with General Purpose Financial Statements, if an entity operates in more than one jurisdiction an NPO may have to produce a General Purpose Financial Report for each jurisdiction to meet their individual standards, formats and reporting periods.

3.30 Naturally, the scale and complexity of an NPO's activities will impact on the amount and form of information needed to demonstrate accountability and for decision-making purposes. For more complex NPOs, there will be a need for additional transparency and more sophisticated arrangements. General Purpose Financial Reports that provide both financial and non-financial information are, however, inherently more likely to meet the needs of external stakeholders for accountability and decision-making purposes.

Conclusion to Chapter 3: What are the essential aspects of NPO financial reporting guidance?

3.31 Accrual-based financial information is best able to meet the financial information needs of a wide range of NPO stakeholders. It provides a more comprehensive view of an entity's financial position and performance than either cash-based or modified cash-based information. It improves the information that can be used to hold management to account and make funding and other decisions.

3.32 General Purpose Financial Reports that include non-financial information can best meet the common information needs of stakeholders. Reports that include non-financial information can provide the additional context needed for accountability and decision-making purposes, such as an understanding of an entity's objectives, strategy, risks, and performance. Such information is not provided by either General Purpose Financial Statements or Special Purpose Financial Reports, although Special Purpose Financial Reports can provide information on areas like utilisation of funding for projects and programmes that are generally not included in General Purpose Financial Reports.

3.33 Use of accrual-based financial information and General Purpose Financial Reports that reflect the needs of stakeholders will also allow the three overall project objectives to be met. Chapter 4 examines how international accounting standards and guidance are able to support the objectives of the project.

General Matters for Comment 3

Chapter 3 explains the two key premises for developing the Guidance so that it supports the provision of information that is useful for accountability and decision-making.

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

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

INTERNATIONAL FINANCIAL REPORTING
FOR NON PROFIT ORGANISATIONS

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

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

4.1 Chapter 3 proposed that the project guidance objectives can be met if the Guidance is accrual-based and requires non-financial reporting information. These objectives are:

> **Objective 1:** To improve the quality, transparency and credibility of NPO financial reports.
>
> **Objective 2:** To support the provision of NPO financial information that is useful for decision making and accountability, balancing the needs of preparers and users.
>
> **Objective 3:** To address specific NPO issues, which will promote the comparability of NPO financial reports.

4.2 There are three existing international financial reporting frameworks that are accrual-based and support the provision of non-financial information. These are IFRS Standards, IPSAS, and within the IFRS suite of standards, the *IFRS for SMEs* Standard. There are a number of accrual-based individual jurisdictional-level frameworks and these also provide some broader guidance on management commentary and other narrative reporting. If existing financial reporting standards can be harnessed the Guidance could be developed more rapidly.

4.3 This chapter develops the argument for why the Guidance needs to be based primarily on an international rather than jurisdictional-level framework. It examines 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 also considers the extent to which NPO-specific reporting issues are already addressed by current international standards.

International applicability

4.4 The absence of NPO-specific guidance in many jurisdictions, and the different approaches taken in those jurisdictions where guidance has been developed, means that around the world NPOs are applying different accounting standards and policies to similar economic events and transactions regardless of the basis of accounting. For example, different approaches to recognising income can mean that one NPO recognises grant income when it becomes receivable, another when the cash related to the grant has been received, and a third only to the extent that it has spent the grant.

4.5 In many jurisdictions there is no specific NPO guidance or, where NPO guidance does exist, it closely mirrors existing approaches to the for-profit private sector, public sector reporting or a mixture of the two without adequately taking into consideration the NPO context.

4.6 A limited number of jurisdictions have taken a more NPO-focused approach to the development of guidance, using a variety of sources, including international standards and jurisdiction specific accounting standards that apply to other sectors. Where jurisdictional-level guidance has been derived from international frameworks, this generally reflects a similar conceptual basis to those frameworks. The guidance though, as would be expected, is usually aimed at providing reporting solutions to meet that individual jurisdiction's specific needs, rather than with a view to international applicability.[12] It is also developed within jurisdictional-level due process and is not subject to full international consultation.

4.7 If transparency, consistency and comparability of reporting is to be improved, it is essential that a single set of Guidance is developed that can be applied within and across jurisdictions globally. While the Guidance could be developed from an existing individual jurisdiction's NPO guidance, regulators may be better able to consider adopting the Guidance if it is designed to be internationally applicable rather than to meet an individual jurisdiction's needs, and if it has consistency with international accounting standards in other sectors. This would increase its commonality and allow it to draw on robust international accounting standard setting due process rather than that of an individual jurisdiction.

Project delivery and the use of existing jurisdictional-level and international frameworks

4.8 A solution to the problems facing NPOs and their external stakeholders needs to be developed on a timely basis. Developing a new set of standards for NPOs is not feasible within the timeframes of the project and the sector cannot wait decades.[13] Further, the financial and human resources that would be needed to develop a separate full suite of international standards for NPOs is not currently available to the IFR4NPO project. These limitations on time and resource mean that the Guidance must necessarily draw on existing frameworks.

4.9 The Guidance will need to provide a coherent suite of financial reporting standards for NPOs. While the development of the Guidance will initially be

[12] Further detail on jurisdictional-level guidance is included in Supplementary Information: International and national financial reporting standards and guidance.

[13] By way of comparison, it has taken the International Public Sector Accounting Standards Board (IPSASB) more than 20 years and significant resources to develop its conceptual framework and an increasingly complete set of financial reporting standards for use by public sector entities.

focused on providing solutions for a range of NPO-specific financial reporting issues, the framework(s) on which the Guidance is based needs to cover all of the main economic events and transactions for which NPOs need to account, not just those where NPO-specific solutions are necessary.

4.10 Jurisdictional-level reporting frameworks can provide important supplementary sources for the Guidance. However, for the reasons noted in paragraphs 4.4–4.7, they are not proposed to be the primary frameworks on which the Guidance will be based.

4.11 Instead the Guidance is proposed to be based primarily on one of the international reporting frameworks that provide international, accrual-based financial reporting standards with some additional guidance on narrative type reporting.

4.12 IFRS Standards are primarily for use by private sector entities that are listed on a public exchange (eg stock market) or hold financial assets in a fiduciary capacity (financial institutions). The *IFRS for SMEs* Standard is aimed at those private sector entities that do not have such accountability.

4.13 The *IFRS for SMEs* Standard is a self-contained Standard that is less complex than full IFRS Standards (and many national GAAPs) in a number of ways, including:

- 250 pages compared with over 2,000 pages of text in the full IFRS Standards suite
- Topics not relevant for SMEs are omitted
- Many recognition and measurement requirements are simplified
- Significantly fewer disclosure requirements (c.90% reduction)
- The Standard is written in clear, easily translatable language
- To reduce compliance burdens, revisions are less frequent.

4.14 IPSAS have been developed to meet the reporting needs of public sector entities, but alignment where appropriate with IFRS Standards has always been a key pillar of the IPSAS development process. A formal alignment process exists to ensure the differences between the IFRS Standards and IPSAS financial reporting standards are only those needed to address the specific needs of the public sector. In many instances government and corporate activities are the same and there are clear advantages of using common global financial reporting approaches. These include making financial statements easier to understand for users when similar economic events and transactions are accounted for and reported in the same way by both public and private sector entities.

Figure 4.1: The three international financial reporting frameworks

IFRS Standards

- A single set of globally accepted accounting standards that aims to bring transparency to private sector reporting by enhancing the international comparability and quality of financial information, strengthen accountability, and contribute to economic efficiency.
- IFRS Standards are developed to be used primarily by for-profit entities that are traded on public exchanges or hold financial assets in a fiduciary capacity (eg banks).

The *IFRS for SMEs* Standard

- Within the IFRS suite of standards the *IFRS for SMEs* Standard provides simplified reporting requirements for for-profit organisations.
- Designed to meet the needs of for-profit entities that are not traded on public exchanges or hold financial assets in a fiduciary capacity.

IPSAS

- A single set of accounting standards for use by public sector entities around the world in the preparation of general purpose financial reports.
- Aim to enhance the quality and transparency of public sector financial reporting by providing better information for public sector financial management, accountability and decision making.

4.15 IFRS and IPSAS are each underpinned by their own conceptual frameworks, although there are many concepts in common. The *IFRS for SMEs* Standard is aligned to the IASB's conceptual framework for IFRS. Both conceptual frameworks describe the objective of general purpose financial reporting alongside the key concepts to the development and interpretation of standards.

4.16 Comparison of the IASB's and IPSASB's conceptual frameworks reveals many similarities, including the definition of a reporting entity, the elements of financial statements, and recognition and presentation principles.[14] The differences primarily reflect the different purposes of entities in the private and public sectors. In particular, there are differences in concepts around measurement. For example, many assets are held by public sector entities to deliver public services rather than to generate economic or financial returns and this is reflected in the measurement bases available. The impact of these differences will be highlighted when examining NPO-specific reporting issues later in this chapter.

4.17 These international frameworks have been developed through thorough, transparent and participatory due processes that have global acceptance.[15] They include public exposure and consultation on any new standards or proposed changes to standards.

4.18 The IFRS Foundation has previously acknowledged a need for standardised reporting for NPOs and the need for transparent financial reporting requirements for the sector. However, to date, the remit of IFRS has not been widened to cover NPOs, although the trustees of the IFRS Foundation have stated that they continue to "support the need for transparent financial reporting requirements of not-for-profit bodies."[16]

4.19 The International Public Sector Accounting Standards Board (IPSASB®) has more limited resources than the IFRS Foundation and its standards development programme is at an earlier stage. With pressure to address the remaining needs of the public sector, any extension of its remit to address NPO-specific issues is unlikely.

4.20 Although neither IFRS Standards, the *IFRS for SMEs* Standard nor IPSAS are developed with NPO financial reporting needs in mind, between them they address many similar issues. Using these existing frameworks as a basis for NPO financial reporting could harness their respective hierarchies, structures and legitimacies and provide credibility to the Guidance produced. For these

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[14] See the Supplementary Information: international and national financial reporting standards and guidance for a detailed comparison of the two conceptual frameworks.

[15] Further details on these processes can be found in the Supplementary Information: International and national financial reporting standards and guidance.

[16] **https://cdn.ifrs.org/-/media/project/2015-trustees-review/request-for-views/educational-materials/feedback-statement-request-for-views.pdf**

reasons it is proposed to use international frameworks as the primary basis of the Guidance.

Criteria for evaluating the suitability of international frameworks as a basis for NPO Guidance

4.21 As the international financial reporting frameworks have acceptance as high-quality financial reporting frameworks the criteria used to evaluate these frameworks are focused on other aspects of the project Guidance objectives. Three criteria are proposed to evaluate the suitability of these frameworks as a basis for the development of the Guidance as set out in Figure 4.2.

Figure 4.2 Criteria for evaluating the suitability of international frameworks as a basis for NPO Guidance

Criteria	Description
To what extent does the framework provide guidance on the key NPO-specific issues?	IFR4NPO aims to address those issues that are common across NPOs and specific Guidance will be developed to achieve this. A framework that already provides solutions that meets user needs and are practical to apply in the NPO context will be of more use than one that is silent on these issues or requires accounting treatments that are not appropriate for NPOs.
Will preparers, auditors and users be familiar with and easily able to use the framework?	The extent to which frameworks have been used globally varies significantly. Familiarity with a framework may make it more likely that preparers, users and auditors will accept it as an appropriate basis for the Guidance. As the project is aiming to reduce the reporting burden on NPOs, the complexity of accounting solutions and significance and appropriateness of all accounting standards and disclosure requirements are also important. Frameworks that provide simplified principles, have requirements that are appropriate for NPOs, are easy to understand, and are revised only on a periodic basis are likely to be more useful in the NPO context.
How feasible will the development and maintenance of Guidance under the framework be?	Utilising a framework might require a significant initial and ongoing resource investment to develop and maintain the Guidance. Frameworks that have less complex and fewer accounting solutions, disclosure requirements that are more appropriate in the NPO context, and which are subject to less frequent revision may be more feasible. They will have lower development and maintenance requirements and be better aligned with the resource available.

Assessment of extent of NPO-relevant guidance provided by international financial reporting frameworks

4.22 To assess the extent of guidance on key NPO-specific issues provided by each international framework, the issues outlined in Part 2 to this document have been considered. The Overview to Part 2 provides information on the list of issues and why they have been included. Further information about these sources is available in the Supplementary Information: Additional project information.

4.23 Figure 4.3 contains a high-level description of some of the key NPO-specific issues and summarises the applicability to NPOs of existing standards under full IFRS Standards, the *IFRS for SMEs* Standard and IPSAS. A fuller assessment can be found in Supplementary Information: Analysis of NPO-specific issues against international standards.

Figure 4.3: Relevance of guidance provided by international frameworks to NPO-specific issues

Relevance of existing international standards to the key NPO-specific reporting issues	Rating
The framework does not provide guidance relevant to the key NPO-specific reporting issues	
The framework provides some guidance relevant to the key NPO-specific reporting issues	
The framework provides a range of guidance relevant to the key NPO-specific reporting issues	

Category	IFRS Standards	The IFRS for SMEs Standard	IPSAS
Accounting for incoming resources			
Accounting for outgoing resources			
Accounting for non-financial assets			
Reporting entity			
Form and content of financial reports			

4.24 This analysis shows that none of the frameworks address all the key NPO-specific issues, although there are many areas where existing guidance could potentially be utilised in the NPO context. IPSAS performs better overall, particularly in areas related to non-exchange transactions and accounting for assets that are held for the services they can provide rather than for cash generation.

Assessment of international financial reporting frameworks against familiarity and ease of use

4.25 The requirements of full IFRS Standards are complex, both in terms of the accounting principles that the standards require and the associated disclosure requirements. NPO preparers would need to understand the requirements of all of the standards. They would also have to make judgements about whether the standards apply to them, particularly where the transactions that might be covered by a standard are insignificant to an NPO. NPOs would need to place reliance on this concept of materiality to determine if a standard needs to be applied and the extent of any disclosures. This would lead to greater work by NPOs and for their auditors.

4.26 IFRS Standards are widely used across the world. Of 166 jurisdictions that have been profiled by the IFRS Foundation, 144 require IFRS Standards for all or most domestic publicly accountable entities. As full IFRS Standards are mainly used by relatively few, larger private sector entities, this will not automatically translate into familiarity for NPO preparers, auditors and users. Among smaller or less complex NPOs, it is unlikely that preparers and auditors will have regularly operated with or be familiar with the requirements of full IFRS Standards.

4.27 The *IFRS for SMEs* Standard omits accounting topics irrelevant for non-listed entities and accounting options are reduced. As it is written in clear, easily translatable language, ease of use is improved. Also, the entire standard is not reviewed on average more than once every five years, providing stability so that users can grow familiar with the requirements.

4.28 However, gaps in NPO-specific topic coverage may lead to NPOs having to create their own interpretations, which impact ease of use. Furthermore, the disclosure requirements of the *IFRS for SMEs* Standard may not always be appropriate in the NPO context given that these entities are likely to have different accountability requirements, including a broader accountability to society.

4.29 The IFRS Foundation advises that 86 jurisdictions require or permit the use of the *IFRS for SMEs* Standard, with a further nine currently considering its application. These include jurisdictions such as the UK that have developed financial reporting standards using the *IFRS for SMEs* Standard at their core. The IFRS Foundation estimate that approximately 95% of all entities are SMEs under the IFRS definition, so although not used in as many jurisdictions as full IFRS Standards, familiarity with the *IFRS for SMEs* Standard could be higher than the comparison of jurisdiction figures suggests. However, the IFRS Foundation figures also demonstrate a large number of jurisdictions that require IFRS Standards for private sector entities traded on public exchanges or that hold financial assets in a fiduciary capacity, use national standards for other entities.

4.30 IPSAS are less widely used than the other frameworks at present, reflecting the relatively low use of accrual accounting by governments and public sector entities globally. Recent figures indicate that of the 37 governments that currently report on accrual, 19 (51%) are using IPSAS either directly, indirectly or as a basis for their own national standards. A large number of governments are currently transitioning to accrual accounting. The 2018 International Public Sector Financial Accountability Index[17] published by IFAC and CIPFA estimates that of the 98 governments projected to be reporting on accrual by 2023, 72 (73%) will be making use of IPSAS.

4.31 The same complexity issues that exist with IFRS Standards are relevant, both in terms of the accounting principles that the IPSAS standards require and their associated disclosure requirements. Ease of use by NPOs may also be impacted by an absence of 'IPSAS for SMEs' to provide simplified reporting requirements where this is appropriate. However, as many of the individual IPSAS standards are closely aligned to IFRS Standards, it is only the standards that deal specifically with public sector specific issues, such as revenue from non-exchange transactions, that will be different and maybe less familiar.

4.32 It is recognised that familiarity with international standards is likely to be mixed across the world. However, the concepts that underpin IFRS Standards, the *IFRS for SMEs* Standard and IPSAS are often in use to a greater or lesser extent in a large number of jurisdictions. Globally, it is expected that more jurisdictions will be familiar with international standards than national frameworks developed in individual jurisdictions.

4.33 This analysis shows that there may be challenges associated with each of the frameworks. However, the *IFRS for SMEs* Standard, being a single standard designed to the meet the needs of a broad range of entities that has been written in plain English and is aligned to the conceptual framework for IFRS, offers significant advantages.

Assessment of international financial reporting frameworks against feasibility of developing and maintaining the Guidance

4.34 Full IFRS Standards have different accounting options available in a number of standards as well as extensive disclosure requirements. It is subject to an ongoing process of change, with frequent updates for new standards or amendments to existing standards.

4.35 This drives complexity and, with potentially frequent changes, would necessitate a significant amount of work to develop guidance. A process of ongoing monitoring for the interpretation and adaption of standards would

[17] www.ifac.org/knowledge-gateway/supporting-international-standards/discussion/international-public-sector-financial-accountability-index

also be needed to assess the impact on the NPO context. Use of the full suite of IFRS Standards would therefore necessitate the investment of significant resource initially and on an ongoing basis to ensure the development and maintenance of the Guidance was consistent with the underlying framework.

4.36 IPSAS is similar as it is also complex, has significant disclosure requirements and is subject to ongoing development and updates. This is partly as a result of maintaining alignment with IFRS Standards where appropriate and also due to the ongoing development of public sector specific standards. Use of IPSAS would have similar development and maintenance implications to full IFRS Standards.

4.37 The *IFRS for SMEs* Standard is a simplified framework that is updated on average every five years or so, with requirements that are not relevant removed or tailored to meet the needs of smaller entities. Developing initial guidance from a standard that is approximately 250 pages as opposed to the approximately 2,000 pages that comprise full IFRS Standards or IPSAS would be easier. Once the Guidance is developed, it would not need to be subject to continual monitoring and update because, although the *IFRS for SMEs* Standard is currently undergoing a comprehensive review, updates to the *IFRS for SMEs* Standard are periodic rather than continual. This would be expected to reduce the resource required to develop and maintain the Guidance.

Conclusion to Chapter 4: How can international financial reporting frameworks assist NPOs?

4.38 Limitations on time and resource available to the IFR4NPO project mean that the Guidance must be based on existing frameworks. These can potentially be either those that are applied in individual jurisdictions or one of three international reporting frameworks.

4.39 Jurisdictional-level frameworks are not expected to have been developed with international application in mind and are subject to jurisdictional-level rather than international due process. An approach based primarily on international standards is therefore proposed to harness their respective hierarchies, structures and legitimacies and provide credibility to the Guidance produced. Jurisdictional-level frameworks, particularly where they draw on these same international standards, can, however, remain important sources when developing the Guidance.

4.40 Guidance that has common features with other international accounting standards and can be applied internationally could reduce the demand and burden on NPOs, by eliminating the need to produce different sets of accounts for regulators in different jurisdictions. It could also improve the usability of financial reports by providing an international solution to a broad range of financial reporting issues that will benefit a broad range of NPO external stakeholders.

4.41 The three existing international frameworks have similar conceptual bases but also key differences. When assessed against suitability criteria, each of the international frameworks display their own different potential benefits and issues as a basis for the Guidance.

4.42 All of the frameworks would enable objective 1 to be met. However, no single existing international framework performs well across all criteria and allows the remaining two objectives to be met. Objective 2 could be met by all three frameworks if adapted to the specific needs of users of NPO financial reports. None of the frameworks would allow objective 3 to be fully met, unless additional NPO-specific guidance was included.

4.43 Chapter 5 therefore develops a proposed way forward designed to meet all of the objectives of the IFR4NPO project Guidance.

General Matters for Comment 4

Chapter 4 has highlighted that limitations on time and resource mean that the Guidance must draw on existing frameworks. International financial reporting frameworks are proposed as the basis of the Guidance, with each having its advantages and disadvantages.

4.a Do you agree that international frameworks are the best start point for the Guidance? If not, why not?

4.b Do you agree with the criteria that have been used to assess the suitability of the existing international frameworks? If not, why not and what other criteria do you believe could be used and why?

4.c Do you agree with the high-level assessment of the existing international frameworks against these criteria? If not, why not? What assessment would you make and why?

Chapter 5: Proposed way forward

Chapter 5: Proposed way forward

5.1 Chapter 4 examined the options for utilising international frameworks to develop the Guidance. Analysis of these frameworks against criteria linked to the project Guidance objectives demonstrates that no single existing international framework is suitable on its own. In particular, none of the frameworks performs well against the criteria linked to Objective 3: *To address specific NPO issues, which will promote the comparability of NPO financial reports.*

5.2 Chapter 5 develops a way forward to meet all of the project Guidance objectives. It proposes a model that takes account of the analysis in Chapter 2 of the accountability and decision-making arrangements in the sector, and the analysis in Chapter 4 of the international frameworks and jurisdictional-level standards that the Guidance could draw on.

5.3 To meet the project timeframes the Guidance is not likely, initially, to be able to meet the needs of all NPOs. This chapter also proposes therefore that while being of use to all NPOs, the Guidance initially focuses on NPOs that have more complex reporting requirements.

Proposed Guidance model

5.4 As none of the international or jurisdictional-level frameworks provide an adequate standalone solution, a proposed model where aspects of different frameworks are brought together as a source for the Guidance has been developed.

5.5 The *IFRS for SMEs* Standard is suggested as the foundational international framework for this model on the basis that it:

- provides a shorter, simplified standalone Standard with reduced disclosure requirements compared with IPSAS or full IFRS Standards, and accounting requirements that are expected, in most cases, to be appropriate for the NPO context
- is aligned with the full IFRS Standards including the conceptual framework and developed in compliance with the IFRS Foundation's due process requirements
- may have an acceptable level of familiarity and acceptance amongst regulators, preparers, auditors and users internationally
- is the most feasible solution as it would require the lowest level of initial and ongoing resource to develop and maintain the Guidance.

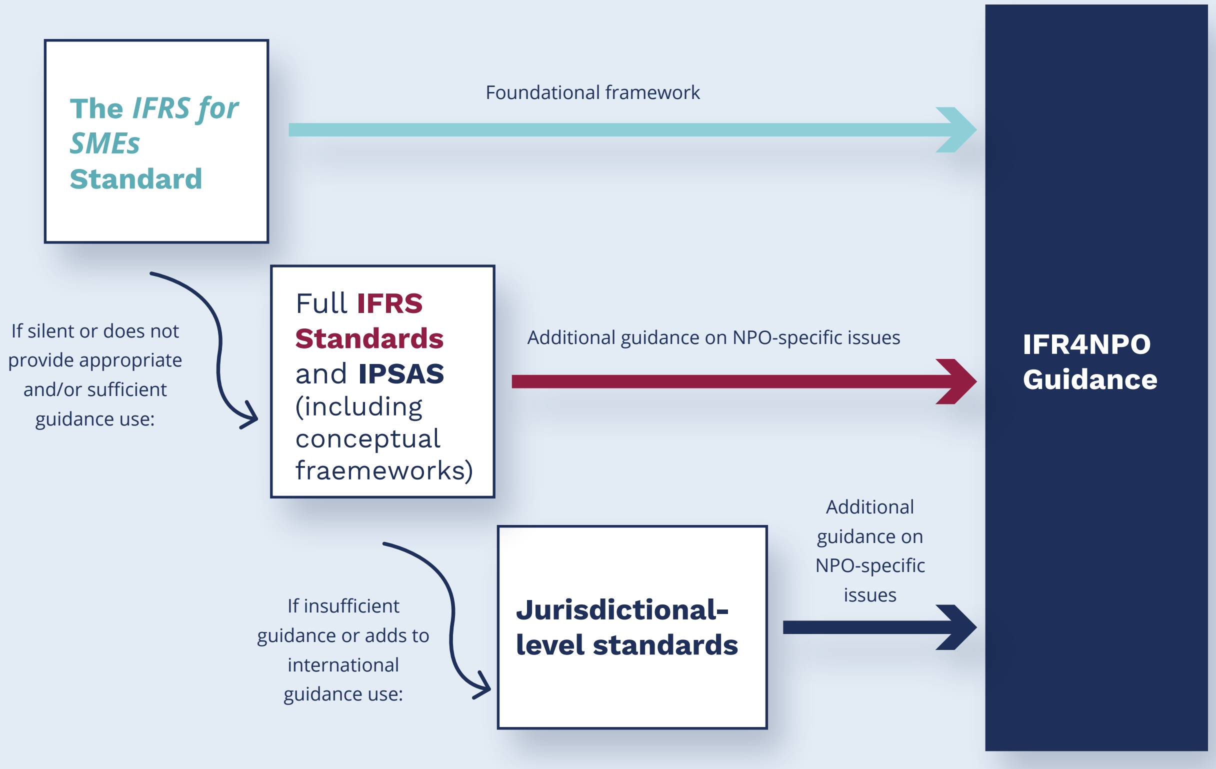
5.6 Where the *IFRS for SMEs* Standard is silent on NPO-specific reporting issues or does not otherwise provide appropriate and/or sufficient guidance, the proposed model would draw on IPSAS, full IFRS Standards, and their broader conceptual frameworks to develop sector-specific reporting solutions. IPSAS may be particularly useful in relation to those transactions that are for social benefit rather than for profit.

5.7 The proposed model would also draw on jurisdictional-level standards to address remaining coverage gaps, particularly where they have been developed in a manner that is sufficiently consistent with the conceptual framework of IFRS Standards and/or IPSAS. Some jurisdictional-level standards already provide interpretations or guidance based variously on the *IFRS for SMEs* Standard, IPSAS and IFRS Standards as well as specific standards and/or guidance based on local GAAP. These may be useful in developing the Guidance, where local interpretations add to international guidance or where there is no content in the existing international frameworks.

5.8 This approach may be particularly useful in considering NPO-specific user needs. This could, for example, include disclosure requirements that differ from those for the for-profit private and public sectors and are tailored to the needs of the users of NPO general purpose financial reports.

5.9 The IFR4NPO Guidance under this proposed model will provide a full suite of financial reporting standards for NPOs. Where there is no requirement for a sector specific reporting solution and the *IFRS for SMEs* Standard provides appropriate and sufficient guidance, the *IFRS for SMEs* Standard will apply directly. Where a sector specific solution is required, the Guidance will utilise full IFRS Standards, IPSAS and/or jurisdictional-level standards as appropriate in line with the proposed model.

Figure 5.1: Proposed Guidance model



Assessing the proposed Guidance model against the criteria

5.10 In Chapter 4, the international frameworks were assessed against three criteria. The same criteria have been used to assess the proposed Guidance model:

Figure 5.2: Comparing use of a single international framework against the proposed Guidance model

Single international framework	Proposed Guidance model
To what extent does the framework provide guidance on the key NPO-specific issues?	
No single international framework provides guidance on all the sector specific issues identified, although IPSAS is stronger in areas where transactions are for social benefit rather than for profit.	Inclusion of full IFRS Standards, IPSAS and jurisdictional-level standards will allow the model to utilise the standards from different conceptually similar frameworks to provide guidance to sector-specific issues.
Will preparers, auditors and users be familiar with and easily able to use the framework?	
Familiarity with full IFRS Standards and IPSAS by NPOs will be limited, and these are complex standards with extensive disclosure requirements. Potential for the *IFRS for SMEs* Standard to be more familiar particularly if it has been incorporated into local GAAP and the framework is designed to be easier to use.	By using frameworks that share a conceptually similar basis, familiarity will be increased. Omitting irrelevant accounting topics for NPOs and appropriate reductions in accounting options and disclosure requirements will also support ease of use.
How feasible will the development and maintenance of Guidance under the framework be?	
Complexity and frequency of change of full IFRS Standards and IPSAS would necessitate a significant amount of initial work and a process of monitoring for the interpretation and adaption of standards for the NPO context. The *IFRS for SMEs* Standard is a simplified framework and subject to more limited periodic revisions so initial and ongoing resource to develop and maintain the Guidance would be reduced.	Utilising the *IFRS for SMEs* Standard as the foundational framework is expected to limit the initial and ongoing resource required to develop and maintain the Guidance. Where full IFRS Standards, IPSAS and jurisdictional-level standards are used, timing differences and changes to these frameworks will need to be monitored to ensure material inconsistencies do not develop.

5.11 The proposed Guidance model performs better overall against the criteria than any individual international framework as it will:

- ensure that the Guidance covers the key NPO-specific issues when no single international framework does
- maximise familiarity and ease of use of the Guidance by using frameworks with a shared conceptual basis and having a foundation of sector appropriate reductions in accounting options and disclosures
- limit both the initial and ongoing resources needed for the Guidance to be developed and maintained.

5.12 Two potential issues that can be raised with the proposed Guidance model are conceptual coherence and timing differences between framework and source guidance updates. On conceptual coherence, there are differences between the objectives of financial reporting on which IFRS Standards and IPSAS are based, but in most respects they are similar[18]. Aspects such as the reporting entity, what comprises useful information, and what financial statements should include, are largely consistent between the two frameworks. The same is true of jurisdictional-level financial reporting frameworks that have been developed in a manner consistent with the conceptual basis of IFRS Standards and IPSAS. The similarities will support conceptual coherence.

5.13 On guidance timing differences, the international frameworks and jurisdictional-level standards are all subject to different standard setting due processes which move at different speeds and deliver outputs on the same and similar topics at varying points in time. This means that even where there is agreement that standards need revision, some frameworks and jurisdictional-level standards will not be updated at the same time as others. In the proposed model, the presumption will be that the requirements of the *IFRS for SMEs* Standard will be followed to provide a stable foundation. Where another framework has been used to provide a sector specific solution then any updates to the underlying standard could be used for that specific aspect of the Guidance as part of the periodic review of the Guidance aligned to updates of the IFRS for SMEs standard.

How will the Guidance benefit different types of NPO

5.14 While at a broad level the accountability and decision-making needs of NPOs stakeholders are similar, NPOs do differ in type, activity, geographical coverage, size and complexity. The financial management issues facing them will vary, and as such they and the users of their financial information will not all share the same reporting needs.

[18] A comparison on the conceptual frameworks is contained in Supplementary Information: International and national financial reporting standards and guidance

5.15 For example, the reporting needs of NPOs with relatively simple operations and transactions to be reported to users of financial information are likely to be more basic. NPOs with more complex operations and transactions that they need to account for and report on to users are, on the other hand, likely to have reporting needs that are more difficult to satisfy.

5.16 As outlined in Chapter 2, NPOs can face significant burdens in complying with different funder and jurisdictional-determined reporting requirements. As such service delivery and funding characteristics can bring additional complexity to financial management for certain types of NPO. This includes those receiving large donations and grants from a number of funders at a jurisdictional and international level and NPOs delivering services across an entire jurisdiction and/or in more than one jurisdiction.

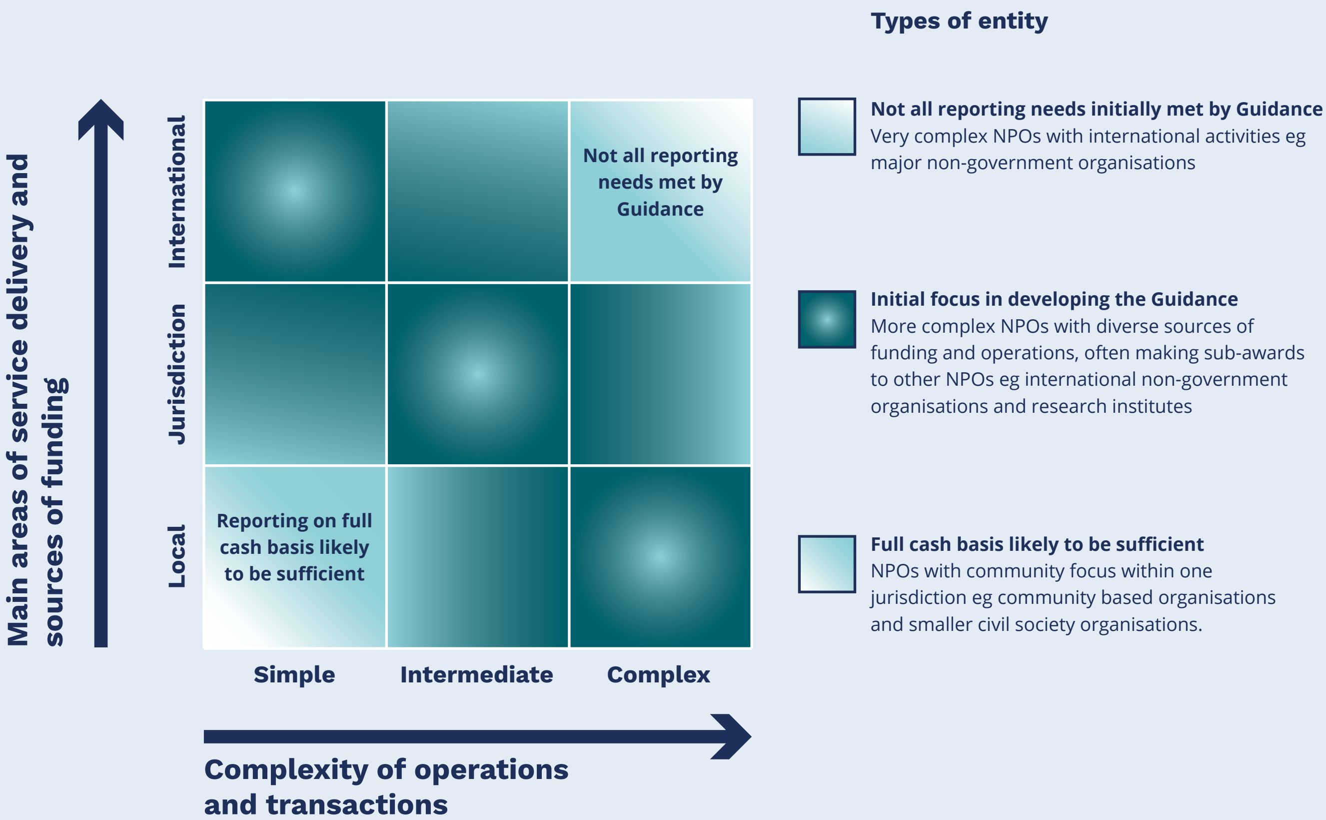
5.17 The Guidance is intended for use by all NPOs irrespective of type or size. Those NPOs with complex operations and transactions and/or that have jurisdictional or international level service delivery and funding characteristics could, however, benefit most from the Guidance through the increasing quality, consistency, transparency, comparability and reliability of financial reporting. It is therefore proposed to focus the development of the Guidance initially on the needs of those NPOs that have complex operations and transactions and/or with reporting burdens driven by their funding and service delivery characteristics.

5.18 In this initial stage the Guidance is not likely to meet all of the reporting needs of the largest international NPOs. These NPOs can have complex financial reporting requirements that are similar to some of the largest private sector organisations and national governments. While the Guidance will be of use to these entities, it is not initially expected to provide full NPO-specific financial reporting guidance relevant to all of the reporting issues they face.

5.19 It is recognised that very small and less complex NPOs, who tend to have local funding sources and deliver services locally, comprise a significant part of the NPO community in many jurisdictions.[19] These NPOs generally focus on ensuring that effective receipts and payments based financial management and reporting processes are in place. Although this approach is likely to be adequate, movement towards financial reporting based on internationally applicable Guidance developed under this project may benefit them over time. This will particularly be the case if they grow and look to attract new sources of funding and/or operate across an entire jurisdiction or in more than one jurisdiction.

[19] Differences in definitions used by jurisdictions make direct comparison difficult but around 60% of NPOs in New Zealand report using the most basic cash accounting tier that is reserved for entities with less than $NZ 125,000 of operating expenses and approximately 40% of UK charitable organisations have less than £10,000 per annum in income.

Figure 5.3: NPOs that are intended to be the initial focus of the Guidance



Conclusion to Chapter 5: Proposed way forward

5.20 Significant improvements can be made to NPO financial reporting by drawing on existing financial reporting frameworks from around the globe. In this chapter, the proposed model provides a credible option for developing the Guidance that will meet the objectives of:

- improving the quality, transparency and credibility of NPO financial reports
- supporting the provision of NPO financial and non-financial information that is useful for decision making and accountability whilst balancing the needs of preparers and users
- addressing specific NPO issues, which will promote the comparability of NPO financial reports.

5.21 The proposed model will deliver Guidance that provides a full suite of financial reporting standards for NPOs. It will utilise the *IFRS for SMEs* Standard as its foundational framework, and draw on full IFRS Standards, IPSAS, and their broader conceptual frameworks where the *IFRS for SMEs* Standard is silent on NPO-specific reporting issues or does not otherwise provide appropriate and/or sufficient guidance, in order to develop NPO-specific reporting solutions. The model will also draw on jurisdictional-level standards to address gaps in coverage of certain topics, particularly where they have been developed in a manner that is deemed sufficiently consistent with the conceptual basis of IFRS Standards and/or IPSAS.

5.22 This proposed model, which can be delivered within the five-year project timeframe, performs better overall against the three criteria used to assess the international frameworks than any one of the three individual frameworks.

5.23 Development of the Guidance is proposed to focus initially 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 do not provide adequate solutions.

General Matters for Comment 5

Chapter 5 has put forward a proposed model for developing the Guidance. The proposal uses the *IFRS for SMEs* Standard as the foundational framework and draws on full IFRS Standards, IPSAS and jurisdictional-level standards to develop the Guidance.

5.a 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?