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19 July 2021



**International Financial Reporting for Non-Profit Organisations: Consultation Paper
Part 1: General NPO financial reporting issues**

I am writing on behalf of the UK's Financial Reporting Council (FRC) in response to Part 1 of the above consultation.

Our response draws on the FRC's experience in developing UK and Ireland accounting standards. This includes FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, which addresses issues specific to entities that may be categorised as non-profit organisations (NPOs). Our response also draws on outreach with UK stakeholders on the IFR4NPO project, as well as feedback received during the development of FRS 102. The views expressed in this response are separate from and will not necessarily affect the FRC's future development and maintenance of UK and Ireland accounting standards.

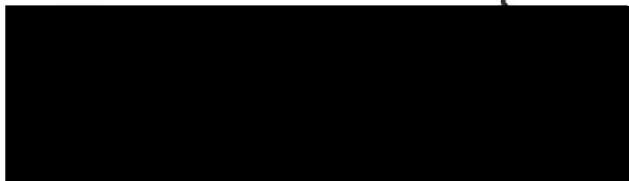
We welcome the opportunity to contribute to the Guidance development process, both through this response and participation in the project's Technical Advisory Group. We believe the project has the potential to contribute towards addressing the gaps that exist in international financial reporting frameworks in relation to the NPO sector. To ensure that the initiative meets its aims, we would encourage the preparation of an impact assessment to enhance the Guidance development process.

We note that the intended benefits of the Guidance are dependent on it being applied internationally. However, we are concerned that the proposed descriptions of the characteristics of NPOs and their stakeholders are too specific and do not acknowledge that these will vary, both between and within jurisdictions. Therefore, we recommend these descriptions are broadened to avoid limiting the applicability of the Guidance and ensure that it can be adopted as widely as possible. We support the overall direction of the proposed model for developing the Guidance but recommend that the decision to draw on different international financial reporting frameworks is supported by a defined process that includes a rebuttable assumption of alignment with the foundational framework.

Our responses to the questions in Part 1 of the Consultation Paper are included in the appendix to this letter. We intend to respond to Part 2 of the consultation in due course.

If you have any queries or would like to discuss our comments in more detail, please do not hesitate to contact Jenny Carter (Director of Accounting & Reporting Policy, [REDACTED], [REDACTED]).

Yours sincerely,



Mark Babington
Executive Director, Regulatory Standards



Appendix: Part 1 – General NPO financial reporting issues

General Matters for Comment 1

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?
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1. We believe that a wide range of organisations are likely to benefit from the Guidance. Therefore, we support focusing on the types of organisations that are *'likely to benefit the most from the Guidance'*, rather than specifying those that are permitted to use it. This approach is similar to the *IFRS for SMEs* Standard, which includes a definition of those entities for which the standard is intended (i.e. its intended scope of applicability). However, it is for individual jurisdictions to determine which entities are required or permitted to use it.
2. To acknowledge the potential scope of the Guidance, we believe the description of NPOs should aim to be as inclusive as possible. This will allow it to contemplate the diversity of entities in the sector and capture future and emerging NPO models.
3. We support the proposed principle-based approach to describing NPOs. However, the current characteristics risk excluding entities that may benefit from the Guidance. To reduce this risk, we recommend the following changes:

Delivering services for public benefit

4. NPOs may provide goods for public benefit rather than deliver services (e.g. the provision of medical or educational supplies). To recognise this business model, the characteristic should refer to the provision of goods or services.

Profits/surpluses are directed for public benefit

5. NPOs may operate using legal structures where the provision of equity and distribution of profit/surpluses is permitted (e.g. social enterprises). For these organisations to be characterised as NPOs, their primary objective should be the delivery of goods or services for public benefit (i.e. demonstrate the previous characteristic). Therefore, we recommend that the explanation of this characteristic does not preclude the distribution of profits but prevents this being the organisation's primary objective.

Voluntary donations and grant funding may be significant

6. Expressing this as a 'possible' characteristic acknowledges that some NPOs receive no or limited voluntary income and/or grant funding. However, it also potentially confuses the organisations that it intends to capture (e.g. private corporation that may receive significant grant funding through subsidies). As the characteristic is often present in organisations that demonstrate the first and second characteristic, we recommend that it is expressed as an indicator rather than a characteristic.

7. In addition, grant funding is referred to from the perspective of recipients only. This risks overlooking NPOs that achieve their objectives through the provision of funding. These organisations could be referred to within the context of the earlier characteristic (*'Delivering services for public benefit'*) to more clearly acknowledge both sides of this transaction.

Assets are held and used for social purposes

8. This characteristic excludes organisations from holding assets to generate a financial return. However, the second characteristic allows organisations to hold assets to generate a financial return where the return is directed to furthering the organisation's public benefit objectives (e.g. NPOs that hold endowment funds). Including both these features as characteristics is potentially confusing. We consider the first and second characteristic as the fundamental indicators of an organisation being an NPO. Therefore, we recommend it is expressed as an indicator rather than a characteristic.
9. In addition, NPOs may hold assets that are used to deliver objectives that may not be explicitly linked to social benefit. The description should be broadened to acknowledge other forms of benefit, for example environmental, public and community benefit. This would include heritage assets that are held for their contribution to knowledge and culture.

General Matters for Comment 2

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?

10. We recommend that the accountability arrangements of NPOs are articulated from the perspective of general-purpose financial reports, rather than focusing on four stakeholder groups. The objective of general-purpose financial reports described in Figure 3.2 of the Consultation Paper includes an open-ended description of potential users that is not restricted to specific stakeholder groups.
11. This approach avoids the list of identified stakeholders having to be relevant to all NPOs and recognises the variety of external and internal stakeholders that NPOs are accountable to. It also acknowledges that the profile and relative importance of different stakeholders will vary and will depend on the NPO's own circumstances. For example, the level of grant funding received by an organisation will influence the extent to which that organisation is considered as being accountable to funders. In addition, the information required to be accountable to these stakeholders may be difficult to cover in an organisation's financial report.
12. This approach is similar to the *IFRS for SMEs* Standard, which describes users in the context of the objectives of general-purpose financial statements. It acknowledges the broad range of potential users and includes examples of who these may be, however, it does not limit this to specific stakeholder groups.

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?

13. We believe that the identified information needs are too specific for the purpose of the Guidance. As a result, there is a risk that neither the needs of those specifically identified stakeholders nor broader stakeholders are adequately addressed.
14. In addition, Guidance that assists NPOs prepare financial reports that cover this range of topics would need to be comprehensive and would be unlikely to be developed within the project's timeline. Such extensive Guidance could also impact on its usability, depending on how significant the change is when compared with existing guidance within a jurisdiction.
15. Rather than focusing on specific aspects of the organisation's performance, we recommend that the contents of NPO general-purpose financial reports focus on broad topics useful for decision-making purposes. This would align with the overall objective of these reports and the approach taken in the *IFRS for SMEs* Standard, which focuses on topics that are useful for economic decision-making. Many of these topics are described in the context of NPOs in Figure 3.2 of the Consultation Paper.
16. This approach is appropriate given the intended scope of the Guidance. As NPO stakeholders and their needs will differ between jurisdictions, the description of both these elements should be kept broad enough to accommodate this variety.

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?

17. We agree with the identified issues, although we would make the observation that whilst general-purpose financial reporting plays a key role in relation to accountability and decision-making, it represents only one of the sources of information that supports these activities.
18. The discussion of donor reporting requirements explains the role that the Guidance could have in reducing diversity in this area. Within the UK, the majority of NPOs prepare general-purpose financial reports using the same financial reporting standards. Despite this, donors and funders continue to request special purpose financial reports. These often contain detailed management information at an individual project level and are required on a periodic basis.
19. Whilst the Guidance has the potential to achieve greater consistency in how the financial information requested by donors is measured and presented, it is unlikely to remove the requirement for it to be prepared and reported. Therefore, we recommend that care is taken to avoid overstating the impact of the Guidance on the current reporting burden faced by NPOs.
20. The variety of information requested by funders also indicates that their information needs differ. These are influenced by a range of factors, including the nature of the funding and the funder's assessment of risk. Given this potential diversity, we recommend that the Guidance avoids focusing on the particular information needs of these specific stakeholders. As discussed in our response to Question 2.a and Question 2.b, by doing so there is a risk that the needs of neither funders nor broader stakeholders are adequately addressed.

General Matters for Comment 3

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

21. We support the development of Guidance that is accrual-based. Within the UK, charities with up to £250,000 income that are not structured as companies have the option to prepare financial statements on a cash basis. We understand that this option is available to the majority of NPOs in the UK and that it is popular.
22. Other jurisdictions may have similar options, and Figure 5.3 notes that for some NPOs a cash basis could be sufficient; therefore the applicability and use of the Guidance could be limited to only a sub-set of all NPOs. If application of the Guidance were to result in the first-time adoption of accrual accounting additional implementation effort and costs would arise, which would be an additional challenge.
23. To increase the scope of the Guidance, consideration could be given to any aspects that may be relevant to entities that report on a cash basis (e.g. non-financial reporting information), or could be adapted for this purpose (e.g. certain disclosures). This could potentially broaden the range of organisations that are likely to benefit from the Guidance. If this were taken forward, it may be necessary to issue this as a separate document in order to maximise its use.

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

24. We support Guidance that includes non-financial information reporting. Doing so is necessary to meet the broader needs and expectations of users of NPOs' financial reports and allow them to obtain useful information. The main challenge with addressing this area is its timing, as there are a number of international initiatives developing non-financial reporting frameworks. Consistent with the guidance on financial reporting, we believe any Guidance should leverage from these initiatives, rather than being developed in isolation from them. Over time, market participants are likely to converge on one or more of these frameworks as the preferred approach. Therefore, waiting for these initiatives to evolve would allow the project to leverage from the most generally accepted framework as the basis for the Guidance.
25. In the interim, we recommend that this area is addressed by developing a set of high-level principles for non-financial reporting. These could identify key areas for NPOs to consider when preparing non-financial information, signalling the key role it plays in NPOs' general-purpose financial reports. These principles could then be used as the starting point for more detailed guidance.
26. An additional challenge is that the title of the project does not suggest that the Guidance will include non-financial information reporting. Whilst this is consistent with other financial reporting frameworks that cover non-financial information, the intended scope of the Guidance is broader and not confined to information that explains the financial performance of an entity. This could create confusion and misunderstanding. Therefore, we recommend consideration is given to how the project's title could better reflect the intended scope of the Guidance.

General Matters for Comment 4

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

27. We agree that international frameworks are the best starting point for the Guidance. There are significant advantages from being able to leverage the work undertaken to develop and maintain these frameworks. Application of the Guidance may also be aided by practitioners' familiarity with these frameworks and the existence of training and educational materials that support their adoption.

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?

28. We broadly agree with the criteria used to evaluate the existing international frameworks (IFRS Standards, the *IFRS for SMEs* Standard, and IPSAS). However, we recommend that the interaction between the criteria and the project Guidance objectives is made clear.
29. Objectives 1 and 2 anticipate Guidance that provides quality, transparent and credible NPO financial reports that are proportionate to the needs of preparers and users. We believe these aspects are relevant in the assessment of a framework's ease of use. However, the description of this criterion in Figure 4.2, and assessment of the frameworks against it, focuses predominately on ease of use from the perspective of preparers who apply the framework, rather than users who are impacted by the information prepared in accordance with it. Therefore, the assessment of a framework's ease of use should more clearly evaluate its impact on NPO financial reports and whether this information is proportionate to the needs of both preparers and users (i.e. supports Objective 1 and 2). Doing so would provide a more complete analysis of the frameworks in the context of the Guidance objectives.

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?

30. We agree with the high-level assessment of the existing international frameworks against the identified criteria. The assessment of the extent of guidance on NPO-specific issues helps illustrate the gaps that the Guidance seeks to address.

General Matters for Comment 5

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?

31. We support the *IFRS for SMEs* Standard being used as the foundational framework. Within the UK financial reporting standards, the requirements applicable to NPOs are based on the *IFRS for SMEs* Standard, supplemented to cover issues specific to this sector. In many instances, the underlying concepts and pervasive principles of the Standard were drawn on to develop those requirements that address these issues. We consider that this approach works well in practice.
32. We believe that Guidance should be aligned as closely as possible with the foundational framework. Drawing on a variety of frameworks has the potential to create solutions that are complex and contribute towards the perceived familiarity costs of the Guidance. To maintain close alignment with the foundational framework, we recommend that the model incorporates a rebuttable assumption that the *IFRS for SMEs* Standard is used as the basis for guidance on NPO-specific issues. Departures from the Standard would have to be warranted and limited to those instances where the Standard is silent or does not provide appropriate and/or sufficient guidance.
33. We recommend that the model includes a process to guide this decision (i.e. to assess the issue to determine whether it warrants a departure from requirements of the *IFRS for SMEs* Standard). This would bring credibility and structure to this aspect of the model. The process could be similar to the process used by the International Public Sector Accounting Standards Board (IPSASB) to review and modify IASB documents¹. Whether an issue warrants departure from the *IFRS for SMEs* Standard would involve considering whether applying the requirements of this standard would mean that the objective of NPOs' general-purpose financial reports would not be met.
34. In the proposed model, jurisdictional-level standards will be drawn on where the guidance in the existing international frameworks is assessed as inappropriate or insufficient. Jurisdictional-level standards are often inextricably linked to the accountability arrangements and legal requirements of that jurisdiction. Therefore, it is important that the context of these standards is fully understood before they are used to provide solutions that are applied more widely.
35. Finally, the following areas are not detailed in the proposed model but are considered relevant to the development of the Guidance:

Format of the Guidance

36. It is not clear how the interaction between the Guidance and the foundational framework will be reflected in the format of the Guidance. One option could be to include guidance on NPO-specific issues as supplementary text within the *IFRS for SMEs* Standard (i.e. as separate paragraphs). This would make clear when the existing requirements of the Standard apply or have been supplemented and/or replaced by the Guidance. We recommend this approach, based on our understanding

¹ Process for Reviewing and Modifying IASB Documents, October 2008, International Public Sector Accounting Standards Board

that it is favoured by preparers as it provides a 'complete' source of requirements for NPO financial reports.

Description as guidance

37. The term 'guidance' implies a level of optionality. However, where the Guidance is applied, the treatments specified within the Guidance will presumably be mandatory, not optional. Therefore, we recommend that the Guidance is described in a way that makes its intended application clear. This would be similar to the *IFRS for SMEs* Standard, which establishes the requirements that those using the Standard must comply with, whilst it is for individual jurisdictions to determine which entities are required or permitted to use it.