

MHA Response to IFRNPO Guidance January 2021 Response Document PART 1: GENERAL NPO FINANCIAL REPORTING ISSUES

Instructions for completion

IFR4NPO has published this document for respondents to use for submitting their comments.

This document presents all of the questions in **Part 1** of the Consultation Paper with spaces for responses.

Respondents are encouraged to complete this document electronically but are not required to use this document. They may also respond using their own comment letter format or the online survey available at: <https://www.ifr4npo.org/cp-survey/>

Comments on **Part 1** are requested by **30 July 2021**

Chapter 1 *What are non-profit organisations?* outlines a broad characteristics approach to describing NPOs for developing the Guidance.

GMC 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?

We agree with the broad characteristics set out in the consultation.

We note that private sector organisations are increasingly adopting socially responsible strategies, supported by investment markets and consumer demands for Environmental, Social and Governance (ESG) characteristics. In addition, there are new organisational models such as B Corps or fair trade organisations which enable entities to demonstrate their commitment to community and societal purposes. It is therefore essential that the characteristics in the final guidance are able to clearly distinguish such entities from NPOs.

We suggest that an essential characteristic of NPOs is that they have a legal organisational purpose, not just a board strategy, to further social or wider societal aims and to advance public benefit.

However, we also consider the definition should be sufficiently wide to include organisations that are not established using established not profit organisational structures but will nevertheless wish to adopt a NPO framework for financial reporting. For example, there are many organisations in the UK that are not registered charities but still adopt the Charities SORP. From a financial reporting perspective, we suggest the final guidance must enable such organisations to be able to follow the principles of accountability and transparency such that their financial statements are able to provide a true and fair view of their activities by being enabled to adopt IFR4NPO.

Chapter 2 *Who are NPO stakeholders and what are their needs?* examines NPO external stakeholders, what information those external stakeholders need for accountability and decision-making purposes, and issues with current arrangements.

GMC 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 that NPOs can be seen as accountable to, and why?

We agree with the stakeholder accountability set out in the consultation. We would however comment on the issue of societal accountability.

Having defined NPOs as having public benefit characteristics it is important that the consultation addresses the issue of what is meant by societal or public accountability.

We recognise that such accountability is generally considered an obligation for NPO status in many territories, however we suggest this is a concept that lacks clarity and understanding. We consider that there is a difference between public accountability and being accountable to the public, press, politicians etc. This difference is often not well-understood.

We consider societal accountability to be principally linked to the organisation meeting its legal and regulatory obligations. In this context we suggest an important characteristic of NPOs is their ability to act independently of the state. Where public services are delivered by NPOs this is typically a funder relationship with contractual responsibilities and accountabilities.

We would also highlight that the assurance requirements of resource providers can determine the financial reporting adopted by NPOs, and whilst we recognise that assurance reporting is not likely to be within the scope of this consultation, it would be helpful if good practice is identified and then signposted by the final guidance.

GMC 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?

We agree with the information requirements for external stakeholders, however we consider these reporting areas will need to be carefully considered to ensure that they are suitable for the size and complexity of the reporting entity, and also that the reporting requirements are practical for substantially all NPOs

For example, we would caution the ability to make meaningful and realistic comparisons of both financial and non-financial performance. The Consultation document refers to reporting on the entity's maximisation of its economy, efficiency and effectiveness, however there are unlikely to be frameworks that will be available to all NPO which enable objective statements to be made. Nevertheless, we consider it would be reasonable for entities to be required comment on how they achieve appropriate economy, efficiency and effectiveness. Similarly, we consider reporting on how an NPO is achieving its objectives is likely to be best achieved by reference to the outcomes and impact of its activities, and whilst various theory of change models are now being used, we would note their adoption is far from universal at present and reporting in the UK is generally not strong even though it is a concept that has existed for over two decades.

GMC 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?

We consider narrative reporting is very important for NPOs in order to demonstrate appropriate accountability. As well as impact reporting noted in our response to 2(b) above, we consider it would be helpful to external stakeholders if reference was made to governance and management matters, the organisation's ethical framework and cultural ethos, and for larger NPOs their environmental sustainability.

The Consultation document helpfully identifies a number of drivers of diversity in current financial reporting, with which we would agree. We would further add, as noted above, that in our experience it is important to recognise that assurance reporting frameworks also contribute to this diversity, and whilst we appreciate it will be beyond the remit of this consultation, we suggest it is appropriate for a piece of parallel work that to consider this alongside the IFR4NPO project.

Chapter 3 *What are the essential aspects of NPO Financial Reporting Guidance?* explains two key premises for developing the Guidance so that it supports the provision of information that is useful for accountability and decision-making.

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

Whilst we agree that accruals-based financial reporting provides an appropriate framework for NPO reporting, we consider it is important to recognise that many NPOs are small in scale and often community-focused and volunteer-run, hence often may not have the capacity or expertise to prepare more technically complex accruals financial statements. We therefore consider there is merit in smaller NPOs having the option to adopt some form of cash-based reporting. Other than for the very smallest or least capable entities, we suggest that a form of modified cash basis reporting can usually provide a good compromise, with a reasonable level of accountability.

Generally, accrual-based financial reporting frameworks seek to address reporting on the financial performance of the reporting entity. Financial reporting for NPOs is typically more concerned about accountability for the stewardship of resources entrusted to and utilised by entities. Accordingly, the interpretation of accruals and matching concepts need to recognise this difference.

Recognition of income from grant and contract funding of NPOs is often a technically complex area and subject to significant judgement and estimation especially if there is a performance-based element to the funding. We consider both performance and accruals models need to be permitted for NPOs to reflect this wide spectrum of funding structures.

Other complex areas which have been addressed fairly successfully in the UK within FRS 102 include Non-exchange transactions, heritage assets, concessionary loans and donated services. However, areas such as the valuation of general volunteer time remain outside normal accounting frameworks.

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

We consider that General Purpose Financial Reports are the appropriate reporting approach for NPOs given that their performance is seldom appropriately measured solely in financial terms.

Narrative reporting of non-financial information has been undertaken in the UK for many years, and certainly since the 1995 Charities Statement of Recommended Practice. However, the standard of this reporting has not developed significantly and remains quite variable in our experience, and more rigorous methodologies for reporting have not gained wide use other than with a small number of mainly larger entities.

As an illustration, after more than 20 years since impact reporting was first attempted for charities in the UK, and despite methodologies such as Social Return on Investment gaining significant interest widely across the world, we are still far from having any agreed framework or standards for such reporting in either the UK or internationally. Whilst developments are continuing it is unlikely that any formal structure will be in place which could be adopted by guidance to be issued for the IFR4NPO review. We consider this should not prevent a strong encouragement for NPOs to seek to adopt this form of performance assessment.

Chapter 4 *How far can existing international financial reporting regimes assist NPOs?* highlights 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.

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

We agree that international frameworks are the best starting point for the guidance on International financial reporting for NPOs. We accept not only the practicality of this approach but the experience that the adoption of international standards with appropriate modifications for non-profit reporting has proven in local jurisdictions to work well, and this has been the case in the UK.

We would also note that non-financial narrative reporting is in a more nascent state than financial reporting, hence we consider this would be a useful area to instead focus the develop of the IFR4NPO guidance.

Furthermore, we consider the proposed approach would enable the limited resources of the project to seek to address areas of NPO financial reporting which have proven difficult to develop acceptable standards and to gain sufficient consensus. For example, as noted above volunteer contributions to NPO activities are often highly significant and add a considerable amount to not only the public benefit of the organisation but also represent a

significant amount of the economic activity of the entity. Yet often there is little attempt to measure or quantify this significant resource being utilised to achieve the NPO's objectives, and any reporting done lacks both rigour and comparability with other organisations.

GMC 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?

We agree.

GMC 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?

We agree.

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

GMC 5(a) What do you see as the main challenges, if any, with the proposed 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?

We agree that the IFRS for SMEs Standard is an appropriate foundational framework to consider and accept this is the most feasible approach given the timeframe for the development of the guidance. We also agree with the hierarchy of additions to this foundational framework as set out in Figure 5.1, though we consider addressing the more complex areas of NPO-specific issues will nevertheless be challenging to undertake with the project deadlines, so it will be essential to identify those issues as early as possible in order to be able to consult sufficiently widely and thoroughly.

MHA

31 July 2021