

IFRNPO Guidance

January 2021

Response Document

PART 2: NPO-SPECIFIC 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 2** 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 2** are requested by **24 September 2021**

Overview – Selection of NPO-specific issues

This part of the Consultation Paper sets out how NPO-specific financial reporting issues have been identified and provides a description of the nature of each issue. Criteria for selecting issues to be included in the initial Guidance are also included.

SMC 0(a) Is the list of NPO-specific financial reporting issues complete? If not, please provide information about the further issues that you believe are specific to NPOs, or issues that should be removed, together with supporting reasoning for the change(s) you propose.

We consider the list is appropriate however we would also suggest as an addition: Heritage Assets both donated and purchased which is noted in Section 4 as being of secondary priority though we would note is of reasonably wide-spread application, not just in the arts, museums and heritage sector, and also disclosures related to related party transactions as in regulatory interventions in the UK conflicts of interest are often a key factor. A further area which is significant for the NPO sector is the accounting and disclosure of pensions costs, and we consider whilst this may not be an initial priority it should be an area on which guidance is provided given the variety of post-employment benefits provided by NPOs.

SMC 0(b) Do you agree with the criteria used to evaluate the list of issues? If not, what changes would you make and why?

We agree with the evaluation criteria.

SMC 0(c) Do you agree with the topics prioritised for the Consultation Paper? If not, outline which topics should be added or removed and why.

We agree with the prioritisation though please note our response (a) above.

Issue 1 – Reporting entity and control (including branches)

Reporting entities need to produce financial statements and so it is important to know what constitutes a reporting entity in the sometimes complex arrangements that surround NPOs. Understanding the accounting implications of these arrangements is key to providing complete and transparent financial information.

Some of the specific questions that this topic is seeking to address are:

- How is control defined (as NPOs may not be exposed to investee returns in a conventional sense)?
- How is a branch defined? Should all branches be accounted for as part of an NPO? What is the status of the financial statements of a branch that is not a separate legal entity?

SMC 1(a) Do you agree with the description of issue 1 – Reporting entity and control (including branches) – in the Consultation Paper? If not, why not?

We agree with the description of the issue, though we consider there is a need for clear guidance about the definition of benefits to the reporting entity as well as the definition of control, as in the not for profit environment identifying non-commercial benefits which nevertheless further purposes of the organisation directly or indirectly can be difficult to determine.

SMC 1(b) Do you agree that the list of alternative treatments that should be considered for issue 1 is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.

We agree with the list, though we would encourage the consultation to consider what disclosures would be appropriate when a relationship is not defined as being one of control and what information it would be appropriate to disclose so readers of the financial statements can sufficiently understand the level and scale of transactions with those non-consolidated branches and other entities.

SMC 1(c) Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment for issue 1? If you do not agree, please set out the changes you propose, and why these should be made.

We agree.

SMC 1(d) Please identify the alternative treatment that you favour for issue 1, and the reasons for your view.

In our experience the operating structures for NPOs can be highly complex and extensive, and often much more so than commercial entities of a similar size, and with often with both central and local governance structures. However, the arrangements can often be quite informal, resulting in a lack of clarity regarding key criteria such as control and benefit. Often the need for clarity in financial reporting can be helpful in encouraging and facilitating NPOs to put in place clearer arrangements which help define and establish legal responsibilities. This therefore would encourage the adoption of a legal approach to financial reporting definitions as a means of improving operational management and governance. However, we

recognise a pragmatic and practical approach can be necessary where legal form is poorly defined, or is prevented by local jurisdictions' legal and regulatory frameworks, hence in order for financial statements to present a true and fair view the substance of arrangements needs to be considered, such as operational impediments to the exercising of control. For example, whilst difficulties in obtaining adequate local audit and assurance requirements should not be the determinant of group financial reporting, this can be a practical difficulty that some NPOs face. Furthermore, our experience is that organisations can find it easier to understand the substance of relationships better than consideration of its legal form. For this reason we would support the adoption of Alternative 1, but would encourage any guidance produced to suggest that well-defined legal form is always to be encouraged.

Issue 2 – NPOs acting on behalf of other entities

The complex arrangements that surround NPOs may mean that in some instances an NPO is acting on behalf of another entity. It can be difficult to determine whether an NPO is merely acting in an administrative role and what its accountability arrangements are.

Some of the specific questions that this topic is seeking to address are:

- When is an NPO acting as an agent and when is it acting as principal?
- Is any disclosure required of the gross amounts relating to agency activity or assets in custody (including cost pass through and assets held on behalf of another entity/person)?

SMC 2(a) Do you agree with the description of issue 2 – NPOs acting on behalf of other entities? – in the Consultation Paper? If not, why not?

We agree with the description of the issues. We would add that in NPO financial statements a key aspect is demonstrating the stewardship of the resources entrusted to the organisation, and it is important to stakeholders to be able to see the accountability regarding such resources. A similar issue relates to the recognition of the input of volunteers.

SMC 2(b) Do you agree that the list of alternative treatments that should be considered for issue 2 is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.

We agree.

SMC 2(c) Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment for issue 2? If you do not agree, please set out the changes you propose, and why these should be made.

We agree

SMC 2(d) Please identify the alternative treatment that you favour for issue 2, and the reasons for your view.

We consider alternative 1 is the most appropriate due to its focus on establishing whether a principal or agency relationship exists. From experience we consider it is necessary to establish a causal link to demonstrate the level of control and responsibility to determine accountability for such funds and resources. This is akin to the IFRS 10 provision relating to the right to control economic benefits, but in a NPO context.

SMC 2(e) Additional disclosures are proposed under all alternatives for issue 2. Outline any challenges you would anticipate with the proposed disclosures? Are there additional disclosure that might be more relevant?

We recognise that disclosure of agency transactions which do not meet the principal definition and hence recognition through primary financial statements will require reporting entities to maintain adequate accounting records. However, we consider that there is a stewardship responsibility over such funds and the NPO will be acting as an agent only as it furthers its purposes, and thereby has an impact on its beneficiaries. A memorandum disclosure of the gross agency transactions is appropriate to demonstrate its accountability for the funds being applied to benefit its beneficiaries.

Issue 3 – Non-exchange revenue

NPOs receive non-exchange revenue from a variety of different resources. NPOs may rely on grants, cash donations, donations of individual items (gifts in-kind), donations of services or volunteer time (services in-kind) and bequests and endowments in order to meet their objectives.

Non-exchange revenue transactions raise specific issues. These issues relate to the recognition, measurement and disclosure of non-exchange revenue.

SMC 3(a) Do you agree with the description of issue 3 – Non-exchange revenue? – in the Consultation Paper? If not, why not?

We consider there are some issues to consider related to exchange transactions. For example NPOs can be funded by both contracts and performance-related grants, both of which are arguably exchange transactions, but the income recognition of both can have issues when the activities or performance required under those funding arrangements have outputs and outcomes that are difficult to define and measure. We note in the UK such transactions can be considered to represent exchange transactions by taxation authorities, for example business activities by HMRC for VAT purposes. The treatments for such funding agreements also seem to differ across jurisdictions, hence we consider they should be addressed in the IFR4NPO guidance.

SMC 3(b) Do you agree that the list of alternative treatments that should be considered for issue 3 is exhaustive? If not, please describe your additional proposed practical alternatives, and explain why they should be considered.

We agree with the application of exceptions.

SMC 3(c) Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment for issue 3? If you do not agree, please set out the changes you propose, and why these should be made.

We agree.

SMC 3(d) Please identify the alternative treatment that you favour for issue 3, and the reasons for your view.

We favour alternative 1 as we consider this best recognises the stewardship imperative for NPO financial statements. However, we do not consider that government grants should be distinguished and treated differently to grants from other sources as we consider this categorisation is not relevant for NPOs. We accept that in some jurisdictions it is appropriate for the level of such incoming resources received by NPOs to be clear, hence we support the clear disclosure of such income separate from other forms of grant support.

SMC 3(e) If you favour an alternative other than alternative 4 for issue 3, do you consider that the exceptions to the recognition and measurement of gifts in-kind and services in-kind should be available under your preferred option?

We accept there may be practical difficulties in measurement of certain gifts-in-kind, particularly assets for resale, but not significant difficulties in consideration of entitlement and probability of receipt. If these practical difficulties are valid then we consider exceptions are appropriate, but we would highlight that there is risk that this becomes the default treatment for some NPOs or for some of the time, hence it should be clear that there is a higher

threshold when applying this exemption. In these instances appropriate disclosure would be necessary for transparency purposes so the scale and extent of such incoming resources can be reasonably appreciated.

SMC 3(f) Are there any practical considerations, for example impacts on tax or audit thresholds, or questions that arise in implementing your preferred option for issue 3?

We accept that adoption of of alternative 1 may affect the recorded level of incoming resources and hence the interaction with threshold for other legislation, which in the UK could include both audit and tax, but we do not consider this to be disproportionate.

Issue 4 – Grant expenses

Many NPOs make grants to other organisations to further their own objectives. This topic is primarily concerned with what expense should be recognised and when, as well as related disclosures.

SMC 4(a) Do you agree with the description of issue 4 – Grant expenses? – in the Consultation Paper? If not, why not?

We agree.

SMC 4(b) Do you agree that the list of alternative treatments that should be considered for issue 4 is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.

We agree

SMC 4(c) Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment for issue 4? If you do not agree, please set out the changes you propose, and why these should be made.

We agree

SMC 4(d) Please identify the alternative treatment that you favour for issue 4, and the reasons for your view.

We favour Alternative 2 as we see merit in there being clarity concerning disclosure of both provisions and commitments which NPOs often describe as “hard” and “soft” obligations. We consider this could be helpful as there are often difficulties in the recognition of constructive obligations when performance conditions have been applied by the grantor, and especially if this relates to a multi-period grant. Often in practice grant-makers have as a priority their programme aims, hence even when formal grant conditions exist they will be flexible in how they apply them if they consider that their broader Not for Profit aims are still being achieved, and this then makes the understanding of the application of the principles of both legal and constructive obligation difficult to apply.

Issue 5 – Measurement of non-financial assets held for social benefit

Tangible and intangible assets that are held for use in delivering the NPO's objectives and not for a financial return is a specific issue for NPOs, particularly where there is a need to impair them.

This topic is seeking to address matters related to:

- How assets are measured initially and subsequently
- Impairment, including when an impairment is recognised, how it is measured and what disclosures should be made.

SMC 5(a) Do you agree with the description of issue 5 – Measurement of non-financial assets held for social benefit? – in the Consultation Paper? If not, why not?

We agree however we consider the issue of mixed use non-financial assets could be explored further as this has practical difficulties and often results in an inconsistent approach.

SMC 5(b) Do you agree that the list of alternative treatments that should be considered for issue 5 is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.

We agree.

SMC 5(c) Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment for issue 5? If you do not agree, please set out the changes you propose, and why these should be made.

We agree.

SMC 5(d) Please identify the alternative treatment that you favour for issue 5, and the reasons for your view.

We favour Alternative 2 as this aligns with existing financial reporting standards and we have not seen any evidence that it does not meet stakeholder requirements and expectations..

SMC 5(e) Do you agree that land and buildings (or sub classifications thereof) used to provide services should be measured using the revaluation model and specifically a measurement which reflects the 'value in use' or the operational capacity to an NPO? Could it provide useful information to users?

We do not agree that land and buildings should be measured using the revaluation model other than where this is necessary for the purposes of deemed cost. For assets used for operational purposes our experience is that stakeholders do not have interest in their value. This has been demonstrated by the inconsistent approach to valuations and significant variations in balance sheet values for similar assets in different NPOs not seemly creating any stakeholder concerns. Furthermore it is generally considered that the costs of obtaining valuations on a regular basis in order to adopt a revaluation policy outway any potential benefit of seeking to reflect current fair values. This is compounded by the difficulties that property professionals have in providing reliable valuations of land and buildings that are often specialised in nature.

Issue 6 – Inventory held for use or distribution

Inventory held for use or distribution to service users has also been identified as a specific issue for NPOs, particularly where the inventory has been donated rather than purchased.

Some of the specific questions that this topic is seeking to address are:

- the initial and subsequent measurement of low value donated goods
- the measurement of perishable inventories and what disclosures should be made about these
- impairment, including when an impairment is recognised, how it is measured and what disclosures should be made.

SMC 6(a) Do you agree with the description of issue 6 – Inventory held for use or distribution? – in the Consultation Paper? If not, why not?

We agree.

SMC 6(b) Do you agree that the list of alternative treatments that should be considered for issue 6 is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.

We agree.

SMC 6(c) Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment for issue 6? If you do not agree, please set out the changes you propose, and why these should be made.

We agree.

SMC 6(d) Please identify the alternative treatment that you favour for issue 6, and the reasons for your view.

We favour Alternative 1 due to being compliance with IFRS Standards and as we consider net realisable value is most likely to be the appropriate manner in which to assess any impairment in value for most situations. We do consider though that it is essential that practical guidance is provided on how to determine values for both cost and net realisable value.

Issue 7– Presentation of financial statements (including fund accounting)

The format and content of financial statements including revenue and expenses is fundamental to how the information is presented to stakeholders. This presentation is particularly important when revenue is restricted or can only be used for particular purposes.

Some of the specific questions that this topic is seeking to address are:

- How should financial statements be presented to help the user's understanding of an NPO's activities? Should there be disclosure of material categories of income and expenses and/or transactions?
- How should unrestricted and restricted funds that can be used for specific NPO purposes be presented in the main financial statements and notes (including reserves)? How does this align with donor reporting requirements? What is the role of fund accounting?

SMC 7(a) Do you agree with the description of issue 7 – Presentation of financial statements? – in the Consultation Paper? If not, why not?

We agree.

SMC 7(b) Do you agree that the list of alternative treatments that should be considered for issue 7 is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.

We agree.

SMC 7(c) Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment for issue 7? If you do not agree, please set out the changes you propose, and why these should be made.

We agree.

SMC 7(d) Please identify the alternative treatment that you favour for issue 7, and the reasons for your view. In your response please consider the presentation of unrestricted reserves allocated for internal purposes.

We favour Alternative 3. The compliance costs associated with the preparation of special purpose financial report and separate assurance reporting on them can be disproportionate to their value, hence if funders are willing to accept supplementary fund/project statements as part of the statutory financial statements this would be a clear benefit. Should that not be possible then the cost of doing this may be a barrier.

The adoption of fund accounting however we consider to be essential in order that there is clarity over the stewardship of funds over which there are restrictions as well as clarity regarding the free reserves position of the NPO at the year end. We consider it is important for stakeholders to be clear where there are limitations concerning the use of certain of the NPOs reserves.

Since the appropriate use of restricted funds derives from limitations imposed by donors, and results in a legal obligation on the NPO to follow, and not only from a financial reporting requirement alone, we consider that fund accounting is just an extension of the underlying

requirement for accountability for such funds. Accordingly it should not be an excessively onerous obligation to follow. Furthermore we consider it necessary to identify fund restrictions for both income and endowment funds. Also our experience is the need for fund accounting for financial reporting purposes, reinforces the need for NPOs to account for and control the use of restricted funds correctly. We consider there is no need to extend fund accounting requirements beyond the income statement and the statement of financial position, for example to be included in a statement of cashflows. Similarly we consider that it is reasonable for disclosure of individual funds to be done only for material funds, and aggregation of smaller funds that are similar in nature is appropriate.

Experience of NPO financial reporting before there was a requirement for clear fund accounting suggests there is a risk of reserve accounting if it is not a requirement and a lack of clarity regarding financial performance. For this reason we would not support the deferral method of accounting for fund which are externally restricted.

Disclosures concerning the NPO's policy on reserves are helpful to stakeholders in understanding the standards of financial management that exist.

SMC 7(e) The term 'statement of financial performance' is used in the Consultation Paper to describe the statement that contains an NPO's revenues and expenses. Do you agree with the use of this term? If not, describe your preferred term and explain your reasoning.

Whilst we do not consider financial "performance" is an appropriate measure for the societal or public benefit impact of a NPO we consider the term 'statement of financial performance' to be acceptable.

Issue 8 – Classification of expenses – function or nature?

NPOs can present their expenses by nature or by function, with at least one jurisdiction having a presentation allowing a hybrid of the two.

Some of the specific questions that this topic is seeking to address are:

- Should there be a standardised format and if so, what should the primary headings be?
- Should the primary analysis of expenses be based on function or nature?

SMC 8(a) Do you agree with the description of issue 8 – Classification of expenses? – in the Consultation Paper? If not, why not?

We agree.

SMC 8(b) Do you agree that the list of alternative approaches that should be considered for issue 8 is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.

We agree.

SMC 8(c) Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment for issue 8? If you do not agree, please set out the changes you propose, and why these should be made.

We agree.

SMC 8(d) Please identify the alternative approach that you favour for issue 8, and the reasons for your view. When considering your preferred approach please comment on which alternative:

(i) provides the best information about the key components of expenses or drivers of performance/activities?

(ii) most closely matches how management reports internally and the way the operation is run (to assist with the cost/benefit assessment)

(iii) whether the alternatives link to any key ratios that might be given in the narrative reporting (and therefore should be something that can be disclosed and reconciled to)

(iv) whether the alternatives permit accountability.

We favour Alternative 3 since we consider this is appropriate for both consistency and comparability between NPOs, but that the approach for reporting in the performance statement should be determined by the financial size of the NPO – functional reporting for larger NPOs and natural reporting for smaller.

SMC 8(e) Do you think that the alternatives for issue 8 provide the right balance between information presented on the face of the performance statement or in the notes?

We agree, however we consider that there should be a proportionate level of disclosure in the notes. Societal interest in activity and functional expenditure in some areas is certainly valid, however in some matters this can be overly narrow and has questionable validity and also can be emotive. This would include disclosures such as “administrative support” or “overhead” costs, though we consider that detailed disclosure of key management personnel is appropriate for accountability and transparency purposes as “executive pay” is a recurrent concern for NPOs.

SMC 8(f) Would the allocation of expenses to functions outlined in issue 8 be so arbitrary that it would not provide a sufficiently faithful representation of the composition of an entity’s functions?

We consider a functional analysis using appropriate functional categories for larger NPOs is consistent with departmental or project analysis that would typically be needed for internal financial management and approaches such as activity based costing or full cost recovery.

SMC 8(g) Are there any practical questions that arise in implementing your preferred option for issue 8?

As noted above we consider functional analysis should be only for larger NPOs given that this can be both complex requiring high level of technical understanding, as well as more costly to undertake for smaller organisations.

Issue 9 – Fundraising costs

Raising funds is critical to the existence of many NPOs. Fundraising activities can take many forms and there is a question about where to report the associated costs.

Some of the specific questions that this topic is seeking to address are:

- How should the costs of fundraising be defined (for example, whether to include business development spend and/or overheads)?
- How should the costs of fundraising be recognised and/or presented (i.e. on a gross basis or netted against income)?

SMC 9(a) Do you agree with the description of issue 9 – Fundraising costs? – in the Consultation Paper? If not, why not?

We agree.

SMC 9(b) Do you agree that the list of alternative approaches that should be considered for issue 9 is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.

We agree.

SMC 9(c) Do you agree with the advantages and disadvantages articulated for each alternative accounting approach for issue 9? If you do not agree, please set out the changes you propose, and why these should be made.

We agree.

SMC 9(d) Please identify the alternative approach that you favour for issue 9, and the reasons for your view.

We favour Alternative 3 as this would be provide greater clarity and consistency on reporting on fundraising costs as a functional activity of the NPO and hence aid comparability and also assessment of performance of fundraising functions.

SMC 9(e) Do you agree that all fundraising costs should be presented gross? If not, please provide examples of where this might not apply and the reasons for your view.

We agree that all fundraising costs should be presented gross.

Issue 10 – Narrative reporting

Non-financial information, which includes management commentary and other forms of narrative reporting, is relevant to NPOs, in demonstrating accountability and stewardship to stakeholders and civil society. For many NPOs, the financial statements may not capture many of the most important aspects of performance.

Some of the specific questions that this topic is seeking to address are:

- What should the narrative/non-financial reporting requirements be for NPOs?

- Should ratios be required for narrative reporting? If they are included, how should costs be classified between support costs and those attributable to operational delivery?

SMC 10(a) Do you agree with the description of issue 10 –Narrative reporting? – in the Consultation Paper? If not, why not?

We agree though we consider that using existing for profit frameworks may not be helpful in recognising the particular benefits in narrative reporting for NPOs.

SMC 10(b) Do you agree that the list of alternative treatments that should be considered for issue 10 is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.

We agree, although we would prefer to see greater emphasis placed on the requirements to report upon the difference the NPO has on its beneficiaries as we consider this is a more helpful assessment of societal or public benefit provided by the NPO than financial performance alone. We also consider it is helpful to disclose more on the effectiveness of the organisation's governance structures and processes, noting the importance of this on the success of the NPO in its mission. Narrative reporting is also helpful in illuminating the difference that non-financial support provided by the NPO has on its beneficiaries, for example through the marshalling of volunteer actions and use of non-profit assets to aid beneficiaries such as through the provision of facilities.

SMC 10(c) Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment for issue 10? If you do not agree, please set out the changes you propose, and why these should be made.

We agree, as comprehensive narrative reporting is a key component of maintaining public trust and making NPOs transparent and accountable.

SMC 10(d) Please identify the alternative treatment that you favour for issue 10, and the reasons for your view.

We favour Alternative 3 as we consider that it is important to develop a sector focussed framework for reporting which provides a strong template for the areas that need to be addressed whilst leaving latitude for interpretation according to the particular activities of the individual NPO, recognising the diverse nature of the sector.

SMC 10(e) Should narrative reporting guidance be set at the level of a framework and principles, rather than any more specific reporting requirements or recommendations? If you disagree, what additional guidance on what specific reporting requirements or recommendations would be beneficial?

The framework and principles approach should be fine as long as there guidance is provided on the level of detail expected to be provided by the NPO. We consider that since the cost of providing this level of reporting is significant and the NPO would require sufficient expertise to draw this up, it would be appropriate to only make this a requirement for larger NPOs above a minimum size threshold. is emphasis placed on the requirements for organisations to report upon the differences they have on their beneficiaries.

