THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ZIMBABWE

ICAZ GUIDANCE AND UPDATE ON FINANCIAL REPORTING FOR NON-PROFIT ORGANISATIONS

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Background

International Financial Reporting Standards (IFRS) have been developed to meet the needs of the private sector, with the interests of investors and creditors driving much of its development. International Public Sector Accounting Standards (IPSAS) have been developed for governmental bodies, acknowledging that the nature of these entities and the information needs of users (including citizens) are different from for-profit businesses. IFRS for Small and Medium-Sized Entities (IFRS for SMEs) have been developed recognising the need for smaller, non-publicly accountable entities, to prepare financial statements, whilst acknowledging that these entities may need simpler standards. IFRS for SMEs therefore, represents a considerable simplification of the full IFRS Standards, is self-contained, tailored to the needs and capabilities of smaller businesses, and is understandable across borders.

For non-profit organizations (NPOs) however, there are currently no equivalent standards. Many NPOs have unique transactions and 'economic events' that are markedly different from those seen in the private or public sectors. Furthermore, stakeholders and users of financial information have reporting needs that do not entirely match those considered by existing international standards. Financial reporting issues for NPOs have been subject to much debate globally for many years. Issues have been raised in academic studies, by standard setters and by stakeholders and members of the NPO community, including donors. Calls for NPO-specific standards have gained momentum not least because of the wide variety of non-profit entities that exist: - humanitarian aid organizations, educational bodies, non-governmental organizations (NGOs) and religious bodies represent just a few.

Examples of the issues that are not adequately addressed in existing international standards include non-exchange transactions, such as the receiving and giving of grants and donations, as well as gifts and services in-kind. Many NPOs rely heavily on cash transfers (grants and donations) for both day-to-day operational costs and projects or programmes. Gifts-in-kind, services-in-kind, fundraising and assets held for future service delivery represent just a few of the transactions that can create real issues when financial reports are compiled using non-NPO specific reporting standards.

Additionally, current reporting standards do not always meet the needs of funders and donors. With the above components of NPO finance not consistently portrayed in NPO financial statements, it can prove difficult for funders to properly assess the health, integrity and historical success of NPOs. Likewise, NPOs can, and do, struggle to better demonstrate their own capacity to potential funders. Additionally, donors may be interested to understand what has happened to their cash donations.

Financial reporting formats also vary among multiple donors, with further complexity arising from requests for different information at different points in time. The picture is even more complicated when you consider the different forms of regulation that must be complied with, if a NPO operates in different jurisdictions. With the potential for numerous due diligence processes to follow and multiple project audits to comply with, NPOs face much more strain than necessary. Overall, there is a vast duplication of efforts – which has a direct impact on NPO capacity, transparency, efficiency and the accuracy of financial information provided.

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Current Practices by NPOs

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Some NPOs are using the IFRS for SMEs for their financial reporting. Although not written for NPOs, IFRS for SMEs contain principles for recognition, measurement and presentation that are relevant to the preparation of financial statements by these entities. Since IFRS for SMEs require additional disclosures when compliance with its specific requirements are insufficient to enable users to understand the effect of particular transactions, events and conditions, providing additional not-for-profit specific information forms part of compliance with the IFRS for SMEs. Finally, the simplicity of IFRS for SMEs lends itself to application in this sector. These factors, together with the credibility and ease of use which comes from applying a recognised international standard, may motivate NPOs to choose IFRS for SMEs for reporting their financial results.

International Financial Reporting Standards for NPOs. Help Shape Them.

Both IASB and International Public Sector Accounting Standards Board (IPSASB) acknowledge their standards were not written with NPOs primarily in mind. The result is that NPO financial statements are highly inconsistent between countries, as NPOs and their auditors seek to apply and interpret different frameworks. Because the existing international standards are often silent on key issues affecting NPOs, such as accounting for donated assets, these issues might be dealt with differently even within the same country, if different preparers and auditors apply different interpretations.

The knock-on effect of this inconsistency is a perceived lack of value to users of NPO general-purpose financial statements, whether for regulation, consolidation, governance, accountability or due diligence. Many funders, unable to monitor the financial performance of their grants and projects in the general-purpose financial statements, require their own formats for project financial reports and demand separate project audits.

In light of this, CIPFA is working with Humentum on the International Financial Reporting for Non-Profit Organizations (IFR4NPO) project, a five-year initiative designed to address these outstanding accounting issues through the development of the world's first internationally applicable financial reporting guidance for the non-profit sector. The IFR4NPO project was launched in July 2019 with the objective to produce internationally applicable guidance for NPOs by April 2025. The consultation stage will end in September 2021 and the exposure draft is expected to be out by May 2023. The guidance for NPOs will be non-mandatory, hence will require assessment to be done by the various stakeholders such as governments, regulators, funders and the NPOs.

To establish firm foundations for the initiative, CIPFA has convened a Technical Advisory Group (TAG), which provides valuable insight on NPO technical accounting issues from national standard setters from every continent, as well as input from the International Accounting Standards Board (IASB). Humentum has convened a Practitioner Advisory Group (PAG), which offers insight and feedback from NPOs, funders, academics, regulators and auditors around the world, all of whom will be using and applying the project's future guidance. Together the PAG and TAG are working to ensure the financial reporting guidance developed by the IFR4NPO project addresses the financial reporting challenges NPOs face globally.

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There is currently a Consultation Paper which is open for feedback from practitioners. The public consultation gives NPOs and their stakeholders the opportunity, for the first time, to contribute to the development of the upcoming guidance. Feedback to this consultation paper will shape the future of financial reporting in this important but diverse sector. The comment period is open until 30 July 2021 on the generic financial reporting issues facing the sector and proposed way forward, and for an additional two months on the specific issues, until 24 September 2021. You can access the consultation paper using this link and send your feedback to ICAZ via email, technical@icaz.org.zw

For more information on this and related matters, contact technical@icaz.org.zw

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