The Chartered Governance Institute UK & Ireland

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Via email

Dear Sir/Madam,

Consultation on IFR4NPO Part 1

On behalf of The Chartered Governance Institute UK & Ireland (the Institute) I am pleased to provide feedback on the IFR4NPO Part 1 consultation.

The Institute is the professional body for governance and the qualifying and membership body for governance professionals across all sectors. Its purpose under Royal Charter is to lead 'effective governance and efficient administration of commerce, industry and public affairs' working with regulators and policy makers to champion high standards of governance and providing qualifications, training and guidance. As a lifelong learning partner, the Institute helps governance professionals to achieve their professional goals, providing recognition, community and the voice of its membership.

One of nine divisions of the global Chartered Governance Institute, which was established 130 years ago, the Institute represents members working and studying in the UK and Ireland and in many other countries and regions including the Caribbean, parts of Africa and the Middle East.

As the professional body that qualifies Chartered Secretaries and Chartered Governance Professionals, which includes company secretaries, our members have a uniquely privileged role in the governance arrangements of different types of organisations in different sectors, including charities and other non-profit making entities. With a detailed understanding of the legal and regulatory framework relating to non-profit entities and practical insights into how such organisations are governed and led, our members are well placed to understand the issues raised by this consultation document and their wealth of expertise and experience has informed our response.

General comments

The Institute supports the principle of developing guidance on financial reporting that covers a wide range of entities within multiple different jurisdictions, but our members' experience is that this is far easier said than done. A recent attempt by BSI to develop an international governance and management standard for non-profits (https://standardsdevelopment.bsigroup.com/projects/2018-03324#/section) encountered several difficult obstacles to developing a truly international document given the different legal and regulatory approaches to non-profits in different countries and the wide disparity in the evolution and history of the sector in some parts of the world. It is not clear how the IFR4NPO project will avoid encountering similar challenges.

While there is some merit in being able to identify and promote universal principles of good financial reporting, there is a groundswell of opinion that the annual reports and accounts of charities in England and Wales, Scotland and Northern Ireland should do more than merely report the financials. The direction of travel appears to be towards better reporting of the impact a charity has made and this is a viewpoint that is equally relevant to other types of non-profit and/or public benefit motivated entities. There is a chance that the culmination of the IFR4NPO project (project end date is proposed as 2025) produces its output at a time when formal reporting by all types of entities has significantly moved on; for example developments to regularise ESG reporting to include sustainability, pay gaps, diversity, climate change and social justice (such as the UN's Sustainable Development Goals).

The Institute suggests that these developments should be considered within the scope of the project to make it more appealing to a broader range of stakeholders and more reflective of modern reporting developments.

All that said, it is important to remember that non-profit organisations (NPOs) range widely in terms of scale and societal impact, with many being run entirely by volunteers for whom the central priority is the purpose of the NPO. Any proposals put forward by the IFR4NPO project will create an infrastructure cost for many of these organisations and it is essential that this be proportionate to the benefit achieved.

Response to specific questions

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

Identifying broad characteristics that are applicable to NPOs in different countries is a challenging task but the characteristics proposed would appear to cover most types of NPO. However, the subtle nuances between different types of these organisations could mean that it is difficult to agree four core identifiers. An alternative might be to offer a range of criteria with a minimum number of criteria required to meet a looser definition of an NPO (a pick and mix approach).

The current characteristics currently identified could lead many NPOs to not self-identify with them, for instance, B-Corps, social enterprises, co-operatives, football trusts, endowed foundations providing grants and professional bodies might not easily identify with the identified criteria (delivering public services, using profit/surpluses for public benefit, possibly having significant voluntary donations and grant funding, and assets held and used for social purposes). Furthermore, three of those criteria could be applied to public sector entities.

2a. 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?

Depending on the range and type of benefits bestowed on different types of NPO, it is likely that the general public are likely to be considered legitimate stakeholders who also demand some form of accountability. A central issue is likely to centre on the proportionality of different levels of accountability to the full range of stakeholders and managing those expectations.

For those non-profit entities with a restricted membership, it is likely that the priority of accountabilities will be those members and the State (in the shape of governments, governmental bodies and regulators). For a foundation which does not attract any State support, the level of accountability can be limited by a government's approach to transparency and accountability.

Furthermore, the approach detailed tends to lean towards entities which work to deliver a primary benefit to humans. For many entities, their primary goals are aimed at the protection and conservation of animals and environment. The benefits to humankind may only be secondary to that aim. Therefore, accountability arrangements might not be as straightforward where the beneficiary class can articulate its expectations in a range of ways.

Many of these accountabilities also apply to publicly funded and/or state services in the form of taxpayer contributions and democratic accountability mechanisms. There is also a recognition, particularly in the UK that commercial entities should be more accountable to a range of stakeholders, e.g. the broadening of s172 under the Companies Act 2006. The challenge for IFR4NPO is to identify those accountabilities that are unique and proportionate to NPOs across the many countries the guidance intends to include.

2b. 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?

The information needs identified within the consultation paper are not unfamiliar to many types of organisations that interact with the broader public: whether as investors, consumers or employees. The only criteria which might be different to the NPO sector is the stated aim of some to 'spend out' within a given timeframe and to dissolve the organisation having met its primary aim. Long-term financial health might therefore not be appropriate in every situation.

As noted above, every type of organisation is facing calls for greater transparency and accountability about the way they undertake their activities and operations. For charities in GB and Northern Ireland, there is a growing recognition that stakeholders want more information about the positive impact a charity has made. That impact might only be achieved by adopting an approach that is not efficient, but is ultimately more effective.

Depending on the lifecycle of an entity, financial metrics might not be the best way of gauging the economy of an entity's administration. This may also be difficult to use as an international metric given the different approaches to labour law, pay and regulatory standards affecting the entity's activities.

Impact reporting may be something that is more unique to the NPO sector and of more interest to a range of stakeholders. This approach might also remove the need to identify an NPO within a specific set of legal structures, especially as charities in GB and Northern Ireland are classed as such because of their purposes not the legal structure adopted.

As noted above, however, any reporting requirements must be proportionate and the fact that an external stakeholder would like any piece of information is not, and should not be treated as, a good reason why that piece of information should be required to be reported.

2c. 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?

As the consultation document rightly highlights, the administrative burden placed on NPOs by different funders requiring different funding reports adds to the calls on limited resources, which might be better dedicated to achieving the primary aims. Any initiatives to encourage large, institutional donors to reach a consensus on their information needs and format could present considerable efficiencies to beneficiary NPOs. It would be helpful to understand how the IFR4NPO project intends to influence those funding entities, of all sizes, to encourage greater consistency in their demands of recipient organisations.

The previous reference to moves to broaden accountability in all sectors to include ESG reporting should be reflected within the project.

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

For many small NPOs, accrual-based accounting will be a challenge, especially where the entity is led by volunteers who do not have recent and relevant financial experience. Proportionality is, as always, key to the development of guidance.

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

The consultation report centres on the presentation of financial information, with little dedicated to non-financial reporting. If non-financial information is limited to impact reporting, the challenge will still be considerable, but universal principles for approaching the measurement of key performance indicators relating to impact might be identifiable. However, attempts to include all relevant governance information are likely to create significant additional work, given the various types of NPOs in existence across multiple legal jurisdictions and within different cultures.

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

Given the timeframe for the project, it appears sensible to start with existing international frameworks. However, such an approach may limit the potential impact of the project because of the shortcomings already built into those frameworks, including the lack of universal criteria for identifying NPOs in different jurisdictions. Reverse engineering the project will undoubtedly take longer, but may be more beneficial to a larger audience in the long run.

5a. 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?

While the use of IFRS for SMEs presents a simplified and shorter framework, there are aspects that will not apply to key NPOs, such as the premise of a profit-making principle and the regulatory limits to the use of funds in some sectors. The Institute acknowledges that the use of a more specific accounting and reporting framework (such as the Charities SORP) or relevant tax code legislation will present more challenges given the different legal arrangements for various types of NPO.

As detailed above, the information needs of stakeholders are changing with a greater desire for readers of accounts to understand the impact an NPO has delivered, rather than the detailed use of financial assets. Using an existing financial standard is unlikely to meet those growing demands for a broader range of disclosures that focus beyond the financials.

It should also be borne in mind that boards of many NPOs are unpaid and that the entities may not have the resources to expend on professional financial accounting and audit advice when it comes to preparing the formal reporting disclosures required by law and regulations. Proportionality is critically important.

With more time and greater resources, a more productive approach might be to return to first principles and create guidance that is set from its foundations to meet the unique needs of the sector while future-proofing it to some degree by incorporating movements in the for-profit world (e.g. greater ESG reporting requirements). For example, what problem is the project trying to solve? Is that the right problem and is it the best solution at this time? If the issue is the diverse reporting requirements of large, institutional funders, is guidance targeted at NPOs the right way or should it be limited to engaging with those funders? If the issue is to improve the reporting of the impact an NPO has made on its intended community, would guidance on measuring and reporting impact more appropriate? If so, is that generic guidance as opposed to sector or activity specific guidance?

Developing guidance that potentially covers trade unions, research foundations, development bodies, educational institutions, professional membership bodies, social enterprises, football clubs and B-Corps (to name a few) is unlikely to meet the needs of each stakeholder group. Perhaps the project would have greater impact if it refocused on a smaller audience (large, institutional funders) to help improve their understanding of the different accounting principles and concepts that informs their decision making when it comes to providing grants and other resources.

I trust the above comments help with the development of this project. Should you require any clarification or have questions relating to this submission, please do not hesitate to contact me directly.

Yours faithfully,

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