Governance & financial accountability in the not-for-profit sector

Prof Louise Crawford PhD CA
Professor of Accountancy
Department of Accounting & Finance
Aberdeen Business School
Robert Gordon University
Aberdeen, Scotland

Presentation given at: University of Bergamo, April 2016
NPO Sector

- So many of NPOs world wide; money/resources flowing into and out of NPOs (civil society) from capital markets and the state; >30,000 international not-for-profits

- Multi-sectorial — advocacy/campaigining, direct support, humanitarian relief, education, religion, medical, community etcé

- Complex geographic reach and relationships

- For charitable NPOs, focus on public benefit/social goals

- A broad mix of organisations with accountability relationships to divers stakeholder groups for a range of social activities and objectives.

- Charity — an intermediary between donors (providing resources) and beneficiaries (recipients of the donors' gifts) (Hyndman and McDonnell, 2009)
NPO Sector – governance challenges

- Corporate governance: from the perspective of agency theory: the ways in which suppliers of finance assure themselves of getting a return on their investment.

- But charities do not return funds to their donors; donors provide funds to enable charities to carry out philanthropic services.

- Return: viewed as the money donated being used for the purpose for which it was donated.

- So governance concerns the relationship between donors and the organisation, including accountability to donors.
NPO Sector – governance challenges

- Governance is also a mechanism of establishing order, minimising conflicts of interest and ensuring effective and efficient achievement of organisational goals.
  - Therefore governance relates to all parties in the organisation to govern behaviour towards achieving a common goal.

- Therefore governance in the NPO sector will/may include:
  - Government regulation; annual reporting; monitoring of paid staff.
  - Developing an implementing internal governance structures (boards of trustees, internal committees, internal controls etc).
  - External governance structures (accounting rules and regulations; external audit or examination).

- Why are mechanisms of governance important in the NPO sector, specifically charities?
  - To ensure continuing ability to attract donations; a charity will have to cultivate a good reputation;
  - Reputational risk is a major risk category of the sector that must be governed.

NPO Sector – why the need for accounts

Accountability is needed to show what is being done to secure resources for the future. This generates:

- Disclosure/reports
- Performance measurement
- Emergence of regulation
- Audit?
- Over-emphasis on quantitatively measurable data
- Increase resources spent on accountability; reduce resources for achieving goals
## Unique Characteristics

<table>
<thead>
<tr>
<th></th>
<th>For Profit</th>
<th>Not for profit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Value/ideology</strong></td>
<td>Profit generation; narrow financial interest</td>
<td>Achievement of NPO social goals; social and public interest values</td>
</tr>
<tr>
<td><strong>Purpose</strong></td>
<td>Commercial</td>
<td>Achieve organisational goals, often with a charitable purpose for a public benefit</td>
</tr>
<tr>
<td><strong>Employee motivation (usually)</strong></td>
<td>Self-interest (agent); conflict with owners (principal)</td>
<td>Collective interests (stewards) and stakeholders with organisational goals</td>
</tr>
<tr>
<td><strong>Sources of income</strong></td>
<td>Customers</td>
<td>Funders/donors/volunteers (voluntary)</td>
</tr>
<tr>
<td><strong>Nature of transactions</strong></td>
<td>Exchange</td>
<td>Primarily non-exchange with/without restrictions</td>
</tr>
</tbody>
</table>
# Accountability challenges

<table>
<thead>
<tr>
<th></th>
<th>For Profit</th>
<th>Not for profit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>From Who</strong></td>
<td>Director (agent)</td>
<td>Trustee/director (Steward)</td>
</tr>
<tr>
<td><strong>For what</strong></td>
<td>Financial wealth creation</td>
<td>NPO mission achievement</td>
</tr>
<tr>
<td><strong>To whom</strong></td>
<td>Present and potential investors, lenders and other creditors</td>
<td>Diverse stakeholders; no clear primary stakeholder – trustees; regulator; funder; employee; volunteer; beneficiaries</td>
</tr>
<tr>
<td><strong>By what means</strong></td>
<td>General Purpose Financial Statements</td>
<td>No agreed method internationally</td>
</tr>
<tr>
<td><strong>Reference</strong></td>
<td>IASB (2010) conceptual framework</td>
<td>Crawford et al., 2016</td>
</tr>
</tbody>
</table>
# International Reporting Practice

<table>
<thead>
<tr>
<th></th>
<th>For Profit</th>
<th>Not for profit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Standard Setter</strong></td>
<td>IASB</td>
<td>None</td>
</tr>
<tr>
<td><strong>Objective of General Purpose Financial Reporting</strong></td>
<td>To provide information about the entity that is useful to assess future net cash inflows (decision-usefulness) and management’s discharged of responsibilities (stewardship) (IASB, 2010, OB4)</td>
<td>n/a</td>
</tr>
<tr>
<td><strong>Qualitative characteristics of relevant information, faithfully represented</strong></td>
<td>Comparable, reliable, timely and understandable (IASB, 2010, QC19)</td>
<td>n/a</td>
</tr>
</tbody>
</table>
International Financial Reporting by NPOs

- There is no IFR framework; no agreed standards; no international standard setting body

- Regulation/oversight difficult therefore

- Plethora of frameworks used across the world

- Effective and efficient operation of the NPO is difficult to assess
So – why not just use IASB standards? ....issues arising...

Å Conceptual framework
   Å Objectives of financial reporting may be fundamentally different from the for-profit sector
      Å IASB focus on decision-usefulness whereas NPOs often focus on stewardship
   Å Users of financial reports ≠ shareholders
   Å The NPO sector does not have an agreed conceptual framework
   Å The NPO sector does not have converged accounting standards ≠ no equivalent to IFRS

Å Reporting Entity
   Å Funds/assets held in trust
   Å Unincorporated entities
   Å Incorporated entity
So ... is there a need for international financial reporting standards for the sector?

Å A cost effective way to **contribute** towards accountability

Å Arguably, standardised, conceptually underpinned accounting standards, implemented globally, may contribute to accountability by underpinning disclosures that is:
   Å complete and relevant;
   Å reliable and comparable between and within jurisdictions
   Å subject to regulation, oversight and audit
   Å transparent, contributing to explaining to stakeholders how the efforts of an NPO translate into outcomes towards mission achievement.(Crawford et al., 2016)
Motivation for the paper – Crawford et al., 2016

• This paper seeks to attain a better understanding of beliefs held, and financial reporting practices implemented, by the community of organisations that form the not-for-profit sector internationally.

• **Scope:**
  • It was agreed that the entire NPO sector — including for example, trade unions, private associations too board
  • Hence, agreed to focus on NPOs which [*see next slide*]:
    • are constituted on a not-for-profit basis; and
    • are self-governing; and
    • are established for public benefit.
Scope of not-for-profit organisations being considered

- Focus on NPOs which:
  - are constituted on a not-for-profit basis; and
  - are self-governing; and
  - are established for public benefit

- In many jurisdictions this corresponds to the understanding of “charities” or organisations established “for public benefit”

- Consideration of NPOs operating across the globe, emphasising large national and transnational NPOs (e.g. Oxfam international, Amnesty International, Save the Children, Medecins Sans Frontieres, Greenpeace International…).
Crawford et al. (2016), Survey Design

Literature review, and online survey, Nov/Dec 2013
19 questions (most with sub-divisions):
- Profile; attitudinal
- Closed questions (often presenting statements with Likert-scale responses)
- Open questions (allowing narrative comments)
- Compulsory and optional questions ì but English only

Circulation:
- International contacts and CCAB steering group
- Lists created of Individuals & Gatekeepers
- Snowball sampling

Responses
- 605 usable responses with direct experience of NPO financial reporting in 179 countries
- Much detail in narrative responses: two thirds completed most of the narrative questions: 63,000 words of comments
- Involvement with NPOs of all sizes:
  - Small community-based organisations under £30K income ï to
  - Large international NGOs £3M+ income

Limitations
Online survey, we asked:

About NPO country-specific reporting being used:
  - Which financial reporting frameworks determine these accounts
  - What are the strengths and weaknesses of preparing financial reports on this basis (open question)

About developing harmonised international standards:
  - Would it be useful to develop international standard(s)
  - Would individual countries be able/willing to use them?
  - What NPO accounting specific issues needed to be addressed
  - Who should comply (size) and why (open question)

About general NPO financial reporting
  - What is the purpose of NPO financial reporting
  - Who is the accountee and why (open question)
  - What are the country-specific influences
Responses by Stakeholder Group

- Employee: 42%
- Trustee: 13%
- Professional Preparer: 10%
- Professional Auditor: 14%
- General Practitioner: 5%
- Regulators: 7%
- Users: 9%
Financial reporting practices in the not-for-profit sector worldwide (by UN classification of countries)

<table>
<thead>
<tr>
<th>Panel A: Types of Accounting used by world region</th>
<th>Africa</th>
<th>Americas</th>
<th>Asia</th>
<th>Europe</th>
<th>Oceania</th>
<th>Worldwide</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td>%</td>
<td>N</td>
<td>%</td>
<td>N</td>
<td>%</td>
<td>N</td>
<td>%</td>
</tr>
<tr>
<td>Cash</td>
<td>68</td>
<td>41%</td>
<td>17</td>
<td>22%</td>
<td>38</td>
<td>34%</td>
<td>46</td>
</tr>
<tr>
<td>Accruals</td>
<td>82</td>
<td>50%</td>
<td>55</td>
<td>71%</td>
<td>55</td>
<td>50%</td>
<td>211</td>
</tr>
<tr>
<td>Other**</td>
<td>15</td>
<td>9%</td>
<td>5</td>
<td>6%</td>
<td>18</td>
<td>16%</td>
<td>11</td>
</tr>
<tr>
<td>Total responses</td>
<td>165</td>
<td>100%</td>
<td>77</td>
<td>100%</td>
<td>111</td>
<td>100%</td>
<td>268</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel B: Financial Reporting Frameworks by world region</th>
<th>Africa</th>
<th>Americas</th>
<th>Asia</th>
<th>Europe</th>
<th>Oceania</th>
<th>Worldwide</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td>%</td>
<td>N</td>
<td>%</td>
<td>N</td>
<td>%</td>
<td>N</td>
<td>%</td>
</tr>
<tr>
<td>Corporate Law</td>
<td>61</td>
<td>16%</td>
<td>23</td>
<td>12%</td>
<td>34</td>
<td>13%</td>
<td>158</td>
</tr>
<tr>
<td>NPO Law</td>
<td>43</td>
<td>11%</td>
<td>26</td>
<td>14%</td>
<td>38</td>
<td>14%</td>
<td>154</td>
</tr>
<tr>
<td>National GAAP</td>
<td>78</td>
<td>20%</td>
<td>46</td>
<td>24%</td>
<td>47</td>
<td>18%</td>
<td>152</td>
</tr>
<tr>
<td>IFRS</td>
<td>47</td>
<td>12%</td>
<td>13</td>
<td>7%</td>
<td>39</td>
<td>15%</td>
<td>33</td>
</tr>
<tr>
<td>IFRS for SME</td>
<td>23</td>
<td>6%</td>
<td>7</td>
<td>4%</td>
<td>9</td>
<td>3%</td>
<td>20</td>
</tr>
<tr>
<td>IPSAS</td>
<td>7</td>
<td>2%</td>
<td>2</td>
<td>1%</td>
<td>3</td>
<td>1%</td>
<td>5</td>
</tr>
<tr>
<td>Regulator</td>
<td>37</td>
<td>10%</td>
<td>20</td>
<td>11%</td>
<td>35</td>
<td>13%</td>
<td>94</td>
</tr>
<tr>
<td>Funder</td>
<td>60</td>
<td>16%</td>
<td>22</td>
<td>12%</td>
<td>31</td>
<td>12%</td>
<td>46</td>
</tr>
<tr>
<td>NPO standards</td>
<td>19</td>
<td>5%</td>
<td>24</td>
<td>13%</td>
<td>20</td>
<td>8%</td>
<td>99</td>
</tr>
<tr>
<td>Other</td>
<td>6</td>
<td>2%</td>
<td>5</td>
<td>3%</td>
<td>8</td>
<td>3%</td>
<td>10</td>
</tr>
<tr>
<td>Total responses</td>
<td>381</td>
<td>100%</td>
<td>188</td>
<td>100%</td>
<td>264</td>
<td>100%</td>
<td>771</td>
</tr>
</tbody>
</table>
Perception: developing an international standard for NPOs
What did our respondents think about developing IFR for NPOs?

<table>
<thead>
<tr>
<th>Perceptions</th>
<th>Not-for-Profit Organisations – View of respondents</th>
</tr>
</thead>
</table>
| To whom for what? | Evidence that those involved in NPO financial reporting rank stakeholders (users of NPO financial reports), with accountability to external stakeholders being prioritised over internal stakeholders, as follows:  
  - Upward financial and fiduciary to external regulators/funders  
  - Downward social to external beneficiaries  
  - Identity to internal trustees/board members  
  - Downward social to internal employees |
| Accountability focus | Stewardship as the primary focus and decision-usefulness as secondary |
What did our respondents think about developing IFR for NPOs?

<table>
<thead>
<tr>
<th>Perceptions</th>
<th>Not-for-Profit Organisations – View of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>By what means?</strong></td>
<td>Converged international financial reporting practice Exhibiting characteristics of: Transparency, reliability, understandability, and to a lesser extent, intra-country comparability; cross-border comparability; To account for NPO specific transactions</td>
</tr>
<tr>
<td><strong>Benefit to NPOs and stakeholders</strong></td>
<td>Reduce compliance burden internationally Increase consistency globally Address the need for guidance and/or international standards for the NPO sector</td>
</tr>
<tr>
<td><strong>Policy implications</strong></td>
<td>Develop international best practice guidance, or develop international reporting standards with the view to seeking endorsement from national regulators.</td>
</tr>
</tbody>
</table>
...Will it happen?

Â Should IASB extend its remit to become the international standard setter for NPOs (Consultation closed November 2015).

...different considerations apply to the private, not-for-profit sector, which internationally has no equivalent of the IASB or IPSASB. In February 2014, the UK Consultative Committee of Accountancy Bodies (CCAB) issued a report (Crawford et al. (2014) which demonstrates a demand for developing international standards for the not-for-profit sector.

The IASB Trustees continue to strongly support the need for transparent financial reporting requirements for not-for-profit bodies. Given the demand for standards to be created for that sector and the lack of an international standard-setter to do that, the Trustees would welcome views on whether the scope of the organisation's mandate should be expanded to encompass not-for-profit bodies (IFRS Foundation, 2015; consultation closed November 2015).
Source – CCAB funded project:

Louise Crawford – University of Dundee, Scotland
Gareth Morgan – Sheffield Hallam University, England
Carolyn Cordery – Victoria University of Wellington, New Zealand
Oonagh Breen – University College Dublin, Ireland

BAFA Conference, 14-16 April 2014, London School of Economics
Public Services and Charities Stream