

International Financial Reporting for Non-Profit Organisations



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Executive summary

The publication of this Consultation Paper gives non-profit organisations (NPOs) and their stakeholders the opportunity, for the first time, to contribute to the development of international financial reporting for the sector. Feedback to this Consultation Paper will shape the future of financial reporting in this important but diverse sector and can be provided in three ways [link here](#).

The preparation of financial statements is crucial for accountability and decision-making and for trust and confidence in NPOs. However, there are no common international accounting standards for NPOs, unlike in the private and public sectors. Only a few jurisdictions have developed guidance that addresses the unique characteristics of NPOs and the types of transactions they undertake.

Donors have developed financial reporting requirements to meet their individual needs, in part due to the lack of a single accepted international accounting framework, but this has resulted in variety of financial reporting requirements. Together with the different laws and regulations that apply in various countries and regions, these different financial reporting requirements can create a heavy burden for NPOs.

The International Financial Reporting for Non-Profit Organisations (IFR4NPO) project aims to respond to these issues by strengthening NPO governance and financial management through the development of internationally applicable financial reporting Guidance for non-profit organisations ('the Guidance'). This will benefit a broad range of NPOs and their stakeholders by making NPO financial reports more transparent, more credible and easier to compare.

The Guidance will be developed over a five-year time frame to meet the following three objectives.

Objective 1: To improve the quality, transparency and credibility of NPO financial reports.

Objective 2: To support the provision of NPO financial information that is useful for decision making and accountability, balancing the needs of preparers and users.

Objective 3: To address specific NPO issues, which will promote the comparability of NPO financial reports.

This Consultation Paper is the first output from the Guidance development process. It is intended to raise awareness and understanding of the project and the issues it will address, as well as to provide a focus and vehicle for stakeholder input. It has been developed in two parts.

Part 1: General NPO financial reporting issues

Part 1 of the Consultation Paper is aimed at a broad audience. It discusses the NPO financial reporting landscape and considers this in the context of the project objectives.

The Consultation Paper proposes a broad characteristics approach to describing the types of organisations most likely to fall within the scope of this Guidance. They are organisations that:

- have the primary objective of delivering services for public benefit, and/or
- direct any surpluses to furthering their primary service delivery objective, and/or
- derive income from voluntary funding, and/or
- hold and use assets for social purposes.

NPO stakeholders need financial reporting information that shows whether an NPO is achieving its objectives in a way that maximises economy, efficiency and effectiveness in the use of resources, while complying with restrictions and regulations, in the context of its longer-term financial health.

General purpose financial reports prepared on an accrual basis that reflect the common needs of a wide range of stakeholders will meet the project objectives. Accrual-based financial information provides a comprehensive view of an entity's financial position and performance. It improves the information that can be used to hold management to account and make funding and other decisions. Narrative, non-financial information provides additional information needed for accountability and decision-making purposes such as an understanding of an entity's objectives, strategy, risks, and performance.

It is proposed that the Guidance draws on existing international financial reporting frameworks to make use of the due process under which they have been developed and enable timely project delivery. There are currently three international reporting frameworks: International Financial Reporting Standards (IFRS® Standards), the IFRS for SMEs® Standard, and International Public Sector Accounting Standards (IPSAS®). The three international frameworks have important similarities but also differences. When assessed against suitability criteria, they each displayed different potential benefits and challenges as possible bases for the Guidance.

The Consultation Paper evaluates the alternatives and proposes the most credible model for developing the Guidance. This model proposes the *IFRS for SMEs Standard* as its foundational framework and draws on full IFRS Standards, IPSAS, and jurisdictional-level standards, where these better meet the needs of NPOs. This proposal performs better overall against suitability criteria than any one individual framework, and can be delivered within the five-year project timeframe.



Part 2: NPO-specific financial reporting issues

Part 2 of this Consultation Paper considers NPO-specific financial reporting issues. It is aimed at those involved in the preparation and audit of NPO financial statements, as well as those who make extensive use of NPO financial reports. It sets out how key NPO-specific issues have been identified to date, provides a description of the nature of each issue and describes the criteria for prioritising the issues to be considered.

Prioritised issues are in the areas of:

- reporting entity
- accounting for incoming resources
- accounting for outgoing resources
- accounting for financial and non-financial assets, and
- presentation, scope and content of financial reports.

Additional analysis is provided for the NPO-specific issues currently prioritised in each area. A description of each issue is provided, why it creates financial reporting issues and how it is addressed in international and/or a selection of national standards and guidance. Alternative approaches that could be pursued to address each issue are also included to generate feedback.

Comments can be provided on any or all the issues raised in both parts 1 and 2 of the Consultation Paper via the three response approaches described [link here](#).

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1. NPO financial reporting – current position

- 1.1 Currently, there are no common international accounting standards for non-profit organisations (NPOs) that are available to be used in every country around the world. A few countries have accounting standards or guidance developed at a national level that address the unique characteristics of NPOs and the types of transactions they undertake. Internationally, when NPO financial reports are prepared on an accrual basis, they are often prepared using accounting standards developed for the private sector, public sector or a mixture of both. Reporting on a cash basis or a modified cash basis is also common among NPOs.
- 1.2 In many countries, NPOs have no guidance or frameworks to support the preparation of financial statements, which are crucial for transparency, accountability and decision making. Funding organisations have filled this void by developing their own reporting requirements for NPOs, and while all have their merits, the variety of different requirements can create a heavy burden on the very organisations they want to support.
- 1.3 Private and public sector entities and their stakeholders have benefited greatly from the development and use of international standards since the 1970s. A 2014¹ international survey, with over 600 responses from 179 countries, found 72% of respondents agreed or strongly agreed that an international accounting standard or guidance specifically for NPOs would be useful.
- 1.4 The COVID-19 pandemic has reinforced the need for change. It has further exposed how the lack of common accounting standards is a barrier to mobilising funding from domestic and international sources for NPOs that have been in the front lines of the response. As the importance and scale of the role played by NPOs in addressing this pandemic and future crises grows, there is increasing urgency to develop common international standards.
- 1.5 The development of NPO guidance would improve the transparency, consistency, comparability, credibility and reliability of NPO financial statements. It would support an increase in trust and confidence in NPO financial statements, and has the potential to reduce compliance costs, which will allow for the release of funds for front-line activities.
- 1.6 The International Financial Reporting for Non-Profit Organisations (IFR4NPO) project is intended to respond to the issues summarised above by developing internationally applicable financial reporting guidance for non-profit organisations ('the Guidance'). The project, which is being funded by donations and grants, is being delivered jointly by the Chartered Institute of Public Finance and Accountancy (CIPFA) and Humentum, both themselves NPOs.²

¹ *International financial reporting for the not-for-profit sector (2014)* – A study commissioned by Consultative Committee of Accountancy Bodies in the UK and Ireland.

² See Supplementary Information – Additional project information for further information.

2. Strengthening NPO governance and financial management

- 2.1** The credibility of NPOs to stakeholders and particularly those who contribute funds is dependent on creating and maintaining trust through making the best possible use of finite resources and making a positive impact for those intended to be helped. This is critical to retaining support and demands strong governance and financial management, which is not uniformly present across NPOs.
- 2.2** Other projects are aiming to strengthen aspects of NPO governance and financial management. These include the 'Good Financial Grant Practice' Standard (GFGP)³ which aims to standardise, simplify and strengthen the financial governance of grant funding, and Money Where it Counts (MWiC),⁴ which aims to standardise information provided to large donors. These initiatives aim to benefit both grant providers and the NPOs receiving them.
- 2.3** These and other similar initiatives are important, but they do not address all the individual problems with NPO governance and financial management. The IFR4NPO Project aims to ensure that its financial reporting outputs build on and complement these initiatives, positively contributing to outcomes that aim to strengthen NPO governance and financial management.
- 2.4** These outputs are intended to play a key role in strengthening the accountability of NPOs around the world. The aim is to address the most important and significant of the broad range of financial reporting issues facing NPOs globally. A single set of guidance will set a clear, professional accounting benchmark for what good financial reporting looks like in the sector.
- 2.5** The Guidance is also intended to give NPOs the means to demonstrate their financial capacity, provide useful information for decision makers and support fundraising. The standardisation possible through the Guidance should also reduce the costs for NPOs in the management of grants and other donations. Similarly, the project aims to reduce costs for funders (eg due diligence) and enable funders to better assess the financial health of potential partners.
- 2.6** The environment for the effective regulation of NPOs, both nationally and internationally, will be improved by more consistent reporting that provides a basis for comparison between organisations and jurisdictions. This will enhance the credibility of NPO financial reporting and support an increase in trust and confidence across the sector. It will also provide the starting point for a more coordinated approach that limits emerging differences among jurisdictions. These outcomes will together lead to better managed, credible, more efficient and accountable NPOs.

³ See www.globalgrantcommunity.com

⁴ The full MWiC protocol can be accessed at: <https://files.humentum.org/fl/T66AWs9Yf5#folder-link/>

3. Guidance objectives

3.1 To strengthen the governance and financial management of NPOs, the Guidance will be developed over a five-year timeframe to meet the following three objectives:

Objective 1: To improve the quality, transparency and credibility of NPO financial reports.

Objective 2: To support the provision of NPO financial information that is useful for decision making and accountability, balancing the needs of preparers and users.

Objective 3: To address specific NPO issues, which will promote the comparability of NPO financial reports.

3.2 Accrual accounting is the accepted basis of international accounting standards. Developing accrual-based guidance will be critical to establishing internationally accepted guidance that meets the broader needs of NPO financial report users. The challenges involved are not underestimated, given the current international prevalence of cash-based or modified cash reporting. Part 1: Chapter 3 explores this area in more detail.

3.3 The Guidance will assist all NPOs in preparing financial reports that meet the general financial information needs of a broad range of stakeholders. It is not intended to include tailored or special purpose reports to address the specific information needs of donors with respect to specific grants.

3.4 All NPOs are expected to benefit from the Guidance: from small membership organisations to large international relief organisations. However, the benefits of the Guidance to individual NPOs will vary because of the diversity of organisations within the sector, the financial reporting environments they operate within, as well as the extent to which there are current jurisdictional-level NPO-specific requirements. Part 1: Chapter 5 provides further information.

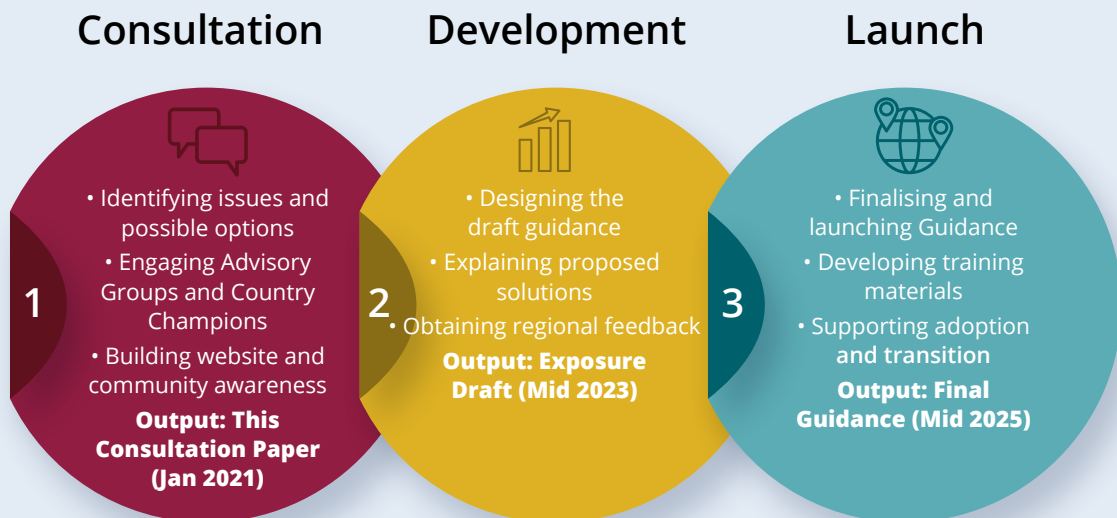
3.5 As with all international financial reporting standards, adoption of the Guidance in full or in part will be for each jurisdiction to determine. The Guidance will therefore be non-mandatory. It will be developed using robust processes to maximise the potential for it to be adopted by any jurisdiction.

3.6 The aim is that funding organisations increasingly use the Guidance in their compliance and due diligence processes and request that grantee financial reports are prepared on a basis consistent with the Guidance.

4. The Consultation Paper

4.1 This Consultation Paper is the first step in developing internationally applicable financial reporting guidance for NPOs. The Consultation Paper provides the first opportunity for those interested in or affected by NPO financial reporting to become acquainted with what the guidance is proposed to cover and how it will be developed. It is intended to generate discussion and encourage comment so that members of the NPO community can contribute to the development of a solution for the sector. The Consultation Paper is the first step in a three-step process as outlined in Figure 4.1.

Figure 4.1: Three-step process for developing NPO-specific international financial reporting guidance



4. The Consultation Paper

- 4.2** Feedback received in response to this Consultation Paper is of critical importance to the project. It will influence the development of the Exposure Draft (ED), which will be the first point at which detailed solutions are developed. The ED is currently planned for publication in mid-2023, with the final Guidance complete in mid-2025. These timings will be reviewed once the consultation responses have been received. The extent and diversity of views among the responses may require this timetable to be extended so that differences of view can be fully considered.
- 4.3** The overriding aim is to engage stakeholders⁵ about the need for common financial reporting guidance that can be applied internationally for NPOs. NPO stakeholders include, for example, senior executives in NPOs, grant makers (large donors), regulators, governments (including tax authorities), auditors, NPO finance teams, creditors, academics and members of the public that support or benefit from the work of NPOs. The Consultation Paper therefore discusses issues that are understood to be important to those individuals or organisations among these groups that have an interest in NPO financial reporting.
- 4.4** The Consultation Paper material has been structured to allow comment on some or all aspects of its contents. This is to encourage input from a wide range of individuals or organisations who may have differing interests in NPO financial reporting.
- 4.5** The Consultation Paper makes a number of proposals. These include a proposed model for developing the Guidance. Making these proposals is intended to enable feedback to be made from a common base, which will then assist with analysis of the responses. Comments provided through feedback will inform the development of the Exposure Draft.
- 4.6** Advice has been taken from the project's advisory groups in developing the Consultation Paper.⁶ The Technical Advisory Group comprises a number of individuals from national standard setters, and the Practitioner Advisory Group comprises individuals from across the NPO community. Members of these groups have been appointed in their individual, voluntary capacity.

⁵ More information about stakeholders and their requirements can be found in paragraphs 2.4 to 2.12 of Part 1: Chapter 2.

⁶ For further information about the Technical Advisory Group (TAG) and Practitioner Advisory Group (PAG) see Supplementary information: Additional project Information.

5. Navigating the Consultation Paper

- 5.1 The Consultation Paper has two parts to allow readers to access the material of most interest to them.

Part 1 addresses broader financial reporting issues and is likely to be of interest to a wide range of individuals and organisations. It deals with framework issues relevant to General Purpose Financial Reporting for NPOs. Part 1 includes consideration of the entities that might be categorised as NPOs and so could benefit from the Guidance, the role of accountability and decision making, the features needed of financial reporting for NPOs and the potential suitability of existing international accounting frameworks. Part 1 includes **General Matters for Comment**, with feedback sought on a number of broader questions, including proposals for how the Guidance should be developed.

Part 2 addresses the technical accounting considerations of specific issues and is likely to interest those who prepare, audit or make extensive use of NPO financial reports. It sets out the process for the identification of key NPO-specific issues, with a description of the nature of each issue, and proposes criteria for selecting issues to be included in the initial Guidance. It also provides more in-depth analysis and consideration of alternative approaches to those NPO-specific issues. Alternatives are based on relevant existing international and national guidance. No recommendation is made about which alternatives should be adopted. Part 2 includes **Specific Matters for Comment**, with feedback sought on the specific issues and possible approaches.

- 5.2 **Supplementary material** supports the content in both Part 1 and Part 2, as well as providing further information about the project and how the Consultation Paper has been developed.
- 5.3 A **glossary of terms** provides the general meanings for terms used in the Consultation Paper to enable readers to engage with the issues and questions raised.
- 5.4 Additional materials will be posted on the IFR4NPO website⁷ to support this Consultation Paper.

⁷ Website: www.ifr4npo.org

5. Navigating the Consultation Paper

Figure 5.1: Summary of Parts 1 and 2 of the Consultation Paper

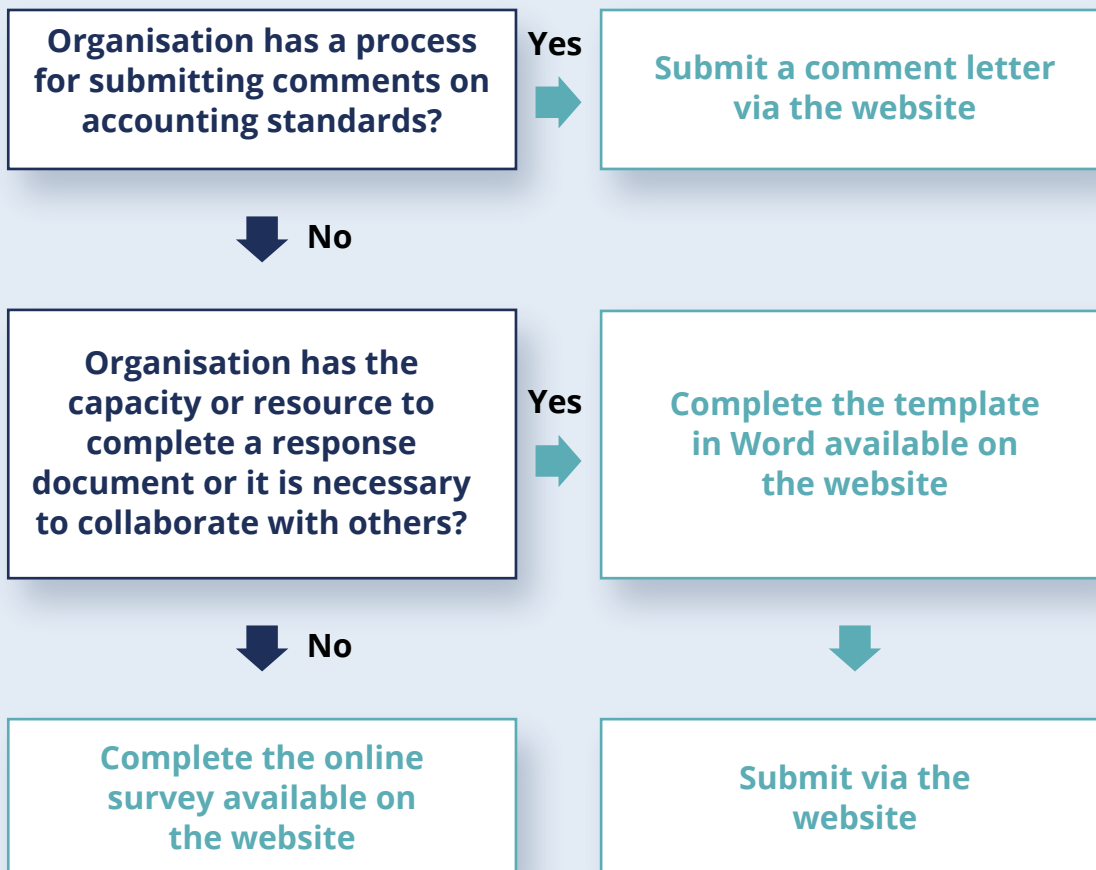


6. Responding to the consultation

- 6.1** Comments are welcome on any or all of the matters discussed in this Consultation Paper.
- 6.2** There is no requirement to respond to all issues. Respondents may provide feedback to all of the questions raised in the Consultation Paper or may choose to respond only about certain elements – there is not a requirement to respond to all questions. This includes the option of responding only to certain specific issues in Part 2. There is no minimum number of Matters for Comment that can be addressed in a response. However, the greater the number of responses received, the richer the feedback for the project team to consider.
- 6.3** Respondents may provide their feedback in one of three ways and should determine which method is most appropriate using the flow chart in Figure 6.1. Those uncertain about which method is most appropriate may contact us [here](#). The methods available are:
- A **comment letter** to be submitted electronically through the website, using the ‘Submit a comment’ link [here](#);
 - The completion of a **proforma word document**. There are separate documents available for responding to Part 1 and Part 2. These can be downloaded from the website [here](#). Once complete the documents should be submitted to the website using the ‘Submit a Comment’ link [here](#).
 - An **on-line survey** accessed through the website [here](#). There are separate surveys available to respond to Part 1 and Part 2.

6. Responding to the consultation

Figure 6.1: Methods available for providing feedback



6. Responding to the consultation

- 6.4** Comments are the most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, and contain a clear rationale, including reasons for agreeing or disagreeing. If you disagree, please provide alternative proposals. All comments will be considered a matter of public record and will ultimately be posted on the IFR4NPO website.
- 6.5** Respondents are requested to include in the response the following details:
- Name of person providing the response and whether this is in an individual capacity or on behalf of an organisation.
 - Description of the respondent's role if an individual.
 - Description of the activities of the organisation where on behalf of an organisation.
 - Jurisdiction to which the feedback relates.
 - Information about the accounting standards used for year-end financial statements in the jurisdiction to which the feedback relates.
 - If from an NPO, the International Classification of Non-Profit Organisation (ICNPO) group that best describes the organisation and its activities.⁸
 - If from an NPO, information about the relative importance of different funding sources (eg grants, donations from members of the public, membership fees, sales proceeds) and overall levels of annual revenue (optional).
- 6.6** The closure dates for responses are as follows:



Comments on Part 1 are requested by 30 July 2021

Comments on Part 2 are requested by 24 September 2021

- 6.7** Although IFR4NPO prefers that comments be submitted via the website, emails may be sent to **IFR4NPO@cipfa.org**. Comments can also be sent in hard copy to:

Head of Programme, IFR4NPO
Chartered Institute of Public Finance and Accountancy
77 Mansell Street
London, E1 8AN
United Kingdom

⁸ http://ccss.jhu.edu/wp-content/uploads/downloads/2011/09/CNP_WP19_1996.pdf



PART 1: General NPO financial reporting issues

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Chapter 1: What are non-profit organisations?

Chapter 1: What are non-profit organisations?

- 1.1 The IFR4NPO Project has been established to develop financial reporting guidance for non-profit organisations (NPOs). This chapter looks at what is meant by the term 'NPOs', and as a result which organisations' financial reports might be addressed by the project's first objective:

Objective 1: To improve the quality, transparency, and credibility of NPO financial reports.

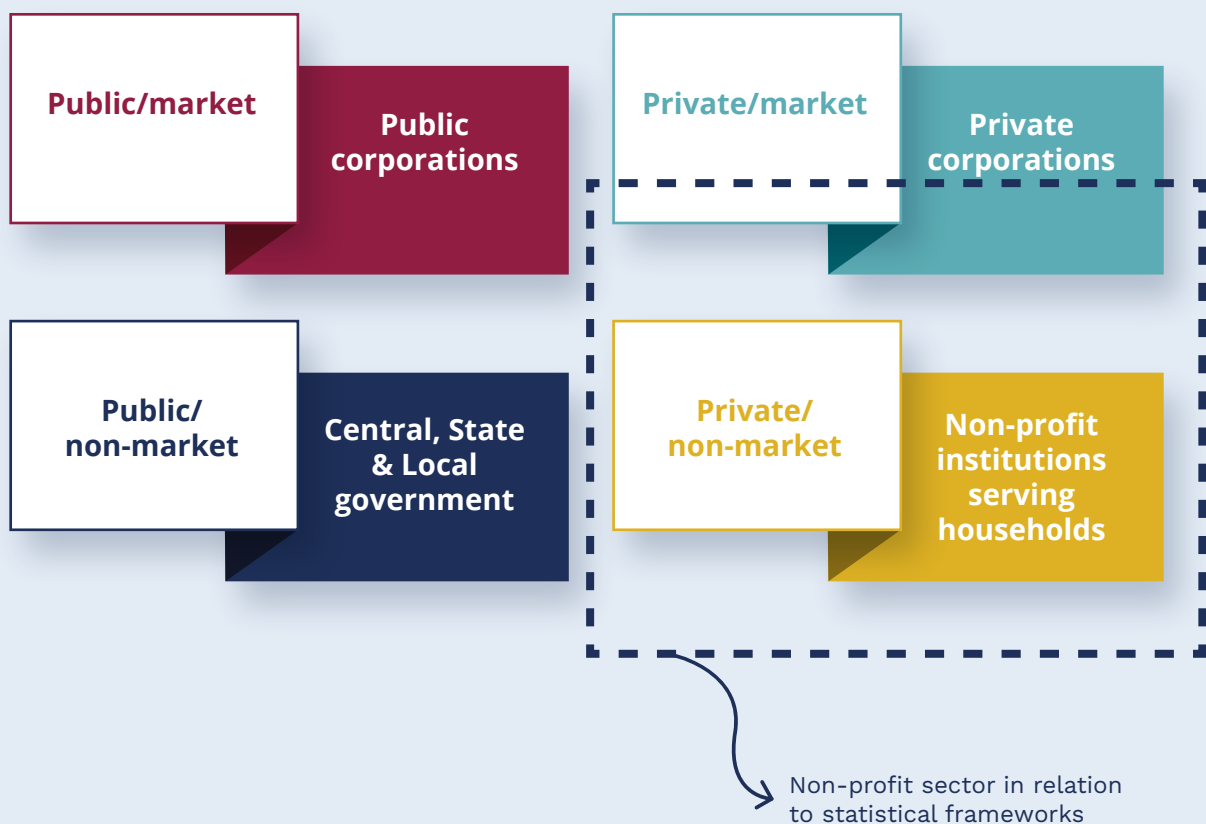
- 1.2 It proposes a broad characteristics approach to describing the entities that the IFR4NPO Project Guidance is expected to primarily benefit.

Broad characteristics approach to describing non-profit organisations

- 1.3 There is a diverse range of organisations that can potentially be considered as NPOs and which could benefit from the Guidance being developed. NPOs range from small community bodies to large international aid organisations. They vary significantly in how they are funded, with sources ranging from public donation, grants and bequests, to significant commercial trading revenue streams. The geographic scope of their operations is also diverse, varying from a defined local area to an entire jurisdiction, with some even having a global reach.
- 1.4 The services delivered by these different organisations are also varied. They include a wide range of activities such as health and social services, education and research, environmental protection, development, aid, advocacy, religion, culture and recreation.
- 1.5 As well as diversity in funding, service delivery, and scope of operations, there is also diversity in the legal and regulatory environments within which NPOs operate. In some jurisdictions, organisations with non-profit characteristics are given special legal and taxation status and may be subject to specific financial reporting requirements and/or guidance. In other jurisdictions no such formal recognition exists, and such organisations are treated in a similar manner to for-profit entities.
- 1.6 Consideration of NPO financial reporting issues and the development of the Guidance requires a common understanding of what is meant when the term 'NPO' is used. With this huge degree of diversity there is a risk that any attempt to describe NPOs may unintentionally exclude entities that might benefit from the Guidance being developed.

- 1.7 There are various existing approaches to classifying sectors of the economy that the IFR4NPO project could draw on to reduce this risk of exclusion.⁹ The work of the organisations that have developed these approaches (which includes for global economic statistics) provides a good platform on which to build.
- 1.8 To enable the production of economic statistics, the key considerations in the existing frameworks include whether an organisation is under private or public/government control, and the extent to which the organisation charges market prices for the goods and services it produces. This results in four broad sectors of the economy and organisations within them.
- 1.9 A wider range of organisations other than just non-profit institutions serving households can however have non-profit characteristics, and so could be described as NPOs. For example, there are private organisations that charge a market price for the goods and services they produce but reinvest any surpluses to furthering service delivery objectives. They do not aim to provide financial returns to investors and as such could also be categorised as NPOs. This is highlighted in Figure 1.1, with the dotted line showing that NPOs can extend beyond the definition under statistical frameworks.

Figure 1.1: Economic sectors and types of organisations



⁹ For examples of existing international classification frameworks and jurisdictional-level approaches to defining NPOs for financial reporting guidance, see the Supplementary Information: Additional project information.

- 1.10** Statistical frameworks have rules rather than being entirely principles-based, so from a financial reporting perspective there are some issues with utilising them directly. These rules, for example, exclude an organisation from being categorised as an NPO if it is not independent of government, whereas some jurisdictions find it useful to permit some public sector entities to be defined as NPOs for financial reporting purposes. To use existing statistical frameworks on their own would therefore result in less focus on some of the important sector specific key economic events and transactions relevant to NPOs on which the IFR4NPO project aims to provide principle-based financial reporting guidance.
- 1.11** Instead of applying an existing framework directly to define NPOs for the purpose of the Guidance, the project is proposing to take a broad characteristics approach to describing which organisations might be NPOs. This approach would use the structural and operational features of NPOs identified in existing frameworks, which could provide a useful start point. The broad characteristics approach would then supplement them to provide a greater focus on the key economic events and transactions relevant to the non-profit sector.
- 1.12** While it is expected that many NPOs will display all of these broad characteristics to a greater or lesser extent, they are intended as indicators of an organisation being an NPO, rather than a set of rules. Therefore, an organisation would not need to demonstrate all characteristics to be considered an NPO for financial reporting purposes. It could have strong alignment with some characteristics and none with the others. For example, some NPOs fund themselves entirely through the sale of goods and services but direct all profits to furthering public benefit objectives. In this example NPOs are expected to benefit from the Guidance but may find some aspects less relevant.

Figure 1.2: Broad characteristics of NPOs



- 1.13** As will be developed in Chapter 2, the Guidance is intended to assist in providing solutions to issues with current accountability arrangements and the provision of decision-useful information. Jurisdictions and funders may find the Guidance useful in improving the accountability and decision-making arrangements of NPOs who account for similar economic events and transactions in order to improve accountability and decision-making arrangements. The adoption of the Guidance in whole or in part by NPOs will be subject to decisions by individual jurisdictions and the requirements of funders.

Conclusion to Chapter 1: What are non-profit organisations?

- 1.14** A broad characteristics approach has been developed to describe the types of organisations that are likely to benefit the most from this Guidance. They are organisations that:
- deliver services for public benefit and/or
 - direct any profits/surpluses for public benefit and/or
 - may have significant voluntary funding and grant income and/or
 - hold and use assets for social purposes.
- 1.15** By adopting this broad description, the project in delivering its objectives can focus on proposals that best meet the needs of the organisations with some or all of these characteristics.
- 1.16** Chapter 2 examines the main stakeholders of NPOs, problems with current accountability arrangements, the provision of decision-useful information, and the implications of this for the development of internationally applicable financial reporting guidance for NPOs.



General Matters for Comment 1

Chapter 1 has outlined a broad characteristics approach to describing NPOs for developing the Guidance:

- 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?



Chapter 2: Who are NPO stakeholders and what are their needs?

Chapter 2: Who are NPO stakeholders and what are their needs?

- 2.1** Chapter 1 described the organisations that are likely to benefit from using the Guidance by focusing on broad characteristics. Describing what makes NPOs different to other types of organisation, both from a structural and operational perspective and with respect to key economic events and transactions, provides a focus for the project, which will support the achievement of Objective 1.

Objective 1: To improve the quality, transparency and credibility of NPO financial reports.

- 2.2** Objective 2 addresses the information needs of NPO stakeholders and users of NPO financial reports. Achieving this objective requires an understanding of the arrangements that support accountability and decision making in the non-profit sector.

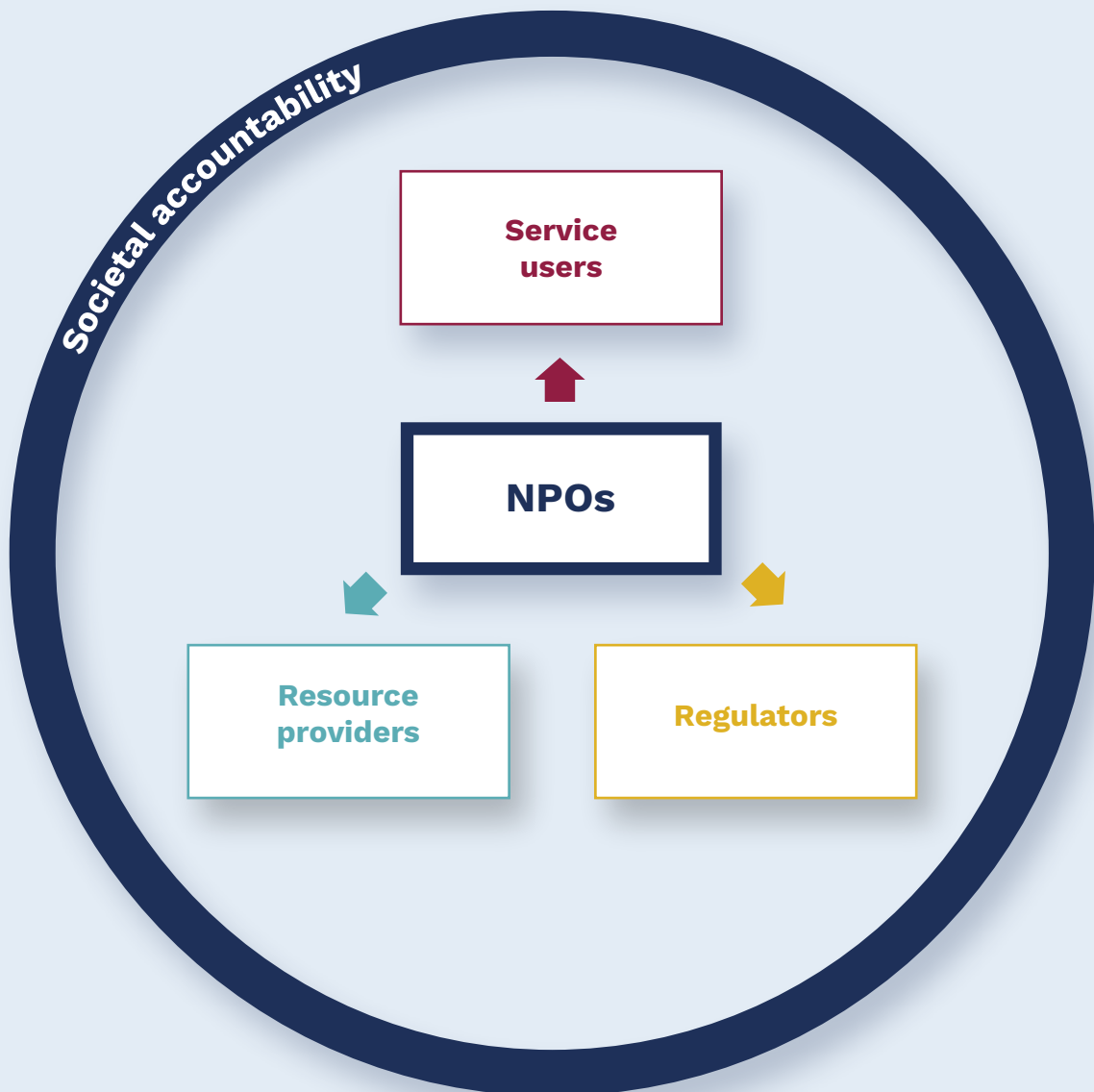
Objective 2: To support the provision of NPO financial information that is useful for decision making and accountability, balancing the needs of preparers and users.

- 2.3** This chapter focuses on the accountability and decision-making arrangements that are most relevant to the external stakeholders to which NPOs are accountable. This includes the high-level information needs of these stakeholders, and their more specific information needs as users of an NPO's financial information. Problems with existing arrangements driven by different jurisdiction and donor reporting requirements are also highlighted.

Which external stakeholders are NPOs accountable to?

- 2.4** Accountability arises when decisions and actions are undertaken by those in a position of responsibility. Accountability entails accepting responsibility for those decisions and actions, together with a requirement to explain them to external stakeholders, be they individuals or entities.
- 2.5** The external stakeholders to whom NPOs are accountable make decisions based on the information provided to them. This could include requests from service users that the entity provide additional or different services, decisions by funders to increase or reduce financial support to projects and programmes being delivered by an entity, or decisions by regulators about whether to continue to provide benefits associated with NPO status.
- 2.6** The broad characteristics of NPOs identified in Chapter 1: Figure 1.2 are useful in understanding the different needs of the broad groups of external stakeholders to whom NPOs may be accountable, illustrated in Figure 2.1.

Figure 2.1. External stakeholder NPO accountability relationships



Service users

- 2.7** The primary objectives of NPOs are to deliver services for public benefit. These services can include a wide range of activities such as health and social services, education and research, environmental protection, development, aid, advocacy, religion, culture and recreation.
- 2.8** Service users are those that benefit directly or indirectly from an NPO's activities. They may also commonly be referred to as service recipients, beneficiaries, or clients. The diversity of services provided by NPOs means that their service users are also diverse. They can range from the entire population in a jurisdiction, to a small subset of a community, or may even be limited to only the members of an NPO.

Resource providers

- 2.9** NPOs often receive donations, grants and funding from other sources. These resources are provided voluntarily to advance the NPO's public benefit objectives without an expectation of a financial return or any direct benefit being returned to the resource provider. Such voluntary resources are often financially significant to an NPO. They can include monetary contributions from the general public, corporate entities, government aid agencies, funding organisations and philanthropic bodies. They may also be non-monetary, such as donated services (for example volunteers providing free labour and services) or goods (for example donated inventory and other assets).
- 2.10** Banks, lenders and other similar bodies will also provide financial resources and other support to NPOs and will seek to ensure that NPOs are complying with requirements they have set in exchange for providing that support.

Regulators

- 2.11** NPOs may receive financial and other privileges by jurisdiction governments to support them in the achievement of their objectives. Regulators ensure NPOs are complying with the legal and regulatory requirements such as delivering services for the public benefit and not solely for private profit as part of these arrangements. The term 'regulators' can include governments, specially established regulatory bodies and other similar organisations.

Societal accountability

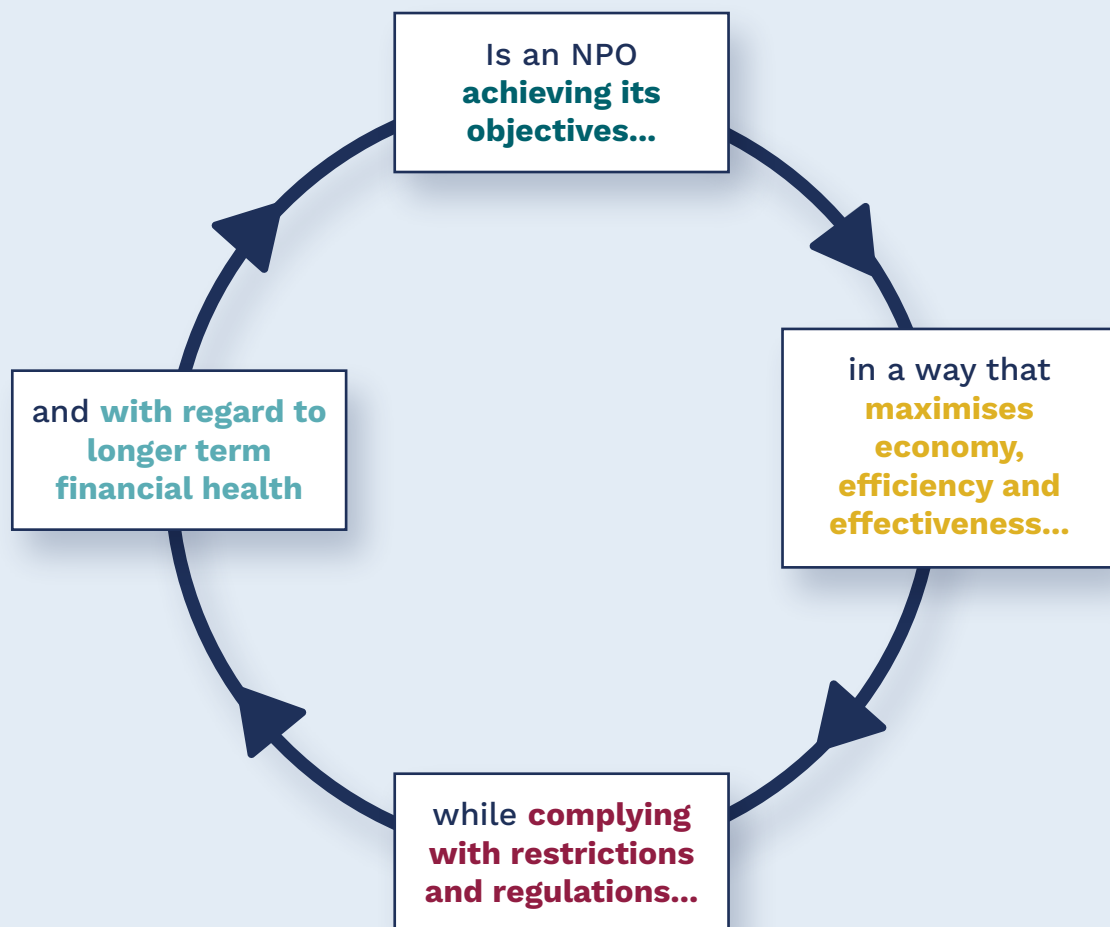
- 2.12** The large number of stakeholders to whom NPOs can be accountable can give rise to a wider societal accountability. This is an expansive view of accountability that recognises a general accountability to society at large. This is due to the importance of NPO services, the funding environment, the preferential treatment that NPOs can receive compared to other organisations, and the need to ensure the effective operation of the wider sector. It requires

transparency, with information available to society as a whole. This notion of a broader accountability is not unique to NPOs and is explained further in Supplementary Information: Additional project information.

What information do NPO external stakeholders need for accountability and decision-making purposes?

- 2.13** Accountability involves the provision of relevant information to external stakeholders by an organisation. Decision-making involves those external stakeholders determining a course of action based on the information provided and the options available. Service users, resource providers, and government, regulatory and similar bodies share some common high-level information needs for accountability and decision-making purposes, even though these arise from different perspectives.

Figure 2.2 Common high-level information needs of external stakeholders



- 2.14** External stakeholders need to know if an NPO is **achieving its objectives**. The primary objective of an NPO is to deliver services for the public benefit, and an NPO needs to demonstrate that resources have been used to deliver services of sufficient quality for service users. If an NPO cannot demonstrate that it is achieving its objectives resource providers may reduce or withdraw the funding they provide to an NPO, or regulatory bodies may decide to withdraw privileges provided to the organisation.
- 2.15** An NPO also needs to demonstrate that these services have been delivered in a way that **maximises economy, efficiency and effectiveness** in the use of resources. This will entail securing inputs of sufficient quality at appropriate cost, and investment in the appropriate amount of administration infrastructure to ensure optimal service delivery. An inefficient NPO is likely to face pressure from service users and funders to improve its operations and direct resources more effectively to service delivery.
- 2.16** External stakeholders will also require information to show that an NPO is **complying with restrictions and regulations**. Resources are often provided for specific purposes by donors, who will need assurance that they have been used only for these purposes, otherwise they may require the resources to be returned to them. Government, regulatory and other similar bodies will need confirmation that an NPO is complying with broader regulations in areas such as operations, governance, purchasing and financing. Without this confirmation, these bodies may revoke regulatory or financial privileges afforded to an NPO.
- 2.17** Finally, an NPO will need to show what is being achieved **in the context of its longer-term financial health**. External stakeholders will want to know that an NPO can continue achieving its objectives, especially if they are utilising an NPO's services or providing financial resources to it. An NPO will, therefore, need to provide external stakeholders with information on the sustainability of its levels of reserves, demonstrate that it has reliable funding sources, and that it has the resources required to meet both current and future costs related to expected levels of activity.
- 2.18** In meeting these needs, information provided to stakeholders will need to be understandable, relevant, reliable and comparable.

Drivers of diversity in current financial reporting for accountability and decision-making purposes

- 2.19** Stakeholder high-level information needs to cover a wide range of management and performance information related to an NPO and its activities. Some external stakeholder groups will primarily be interested in an NPO's financial information and can be referred to as users of an NPO's financial information and reports. Their information needs as users of an

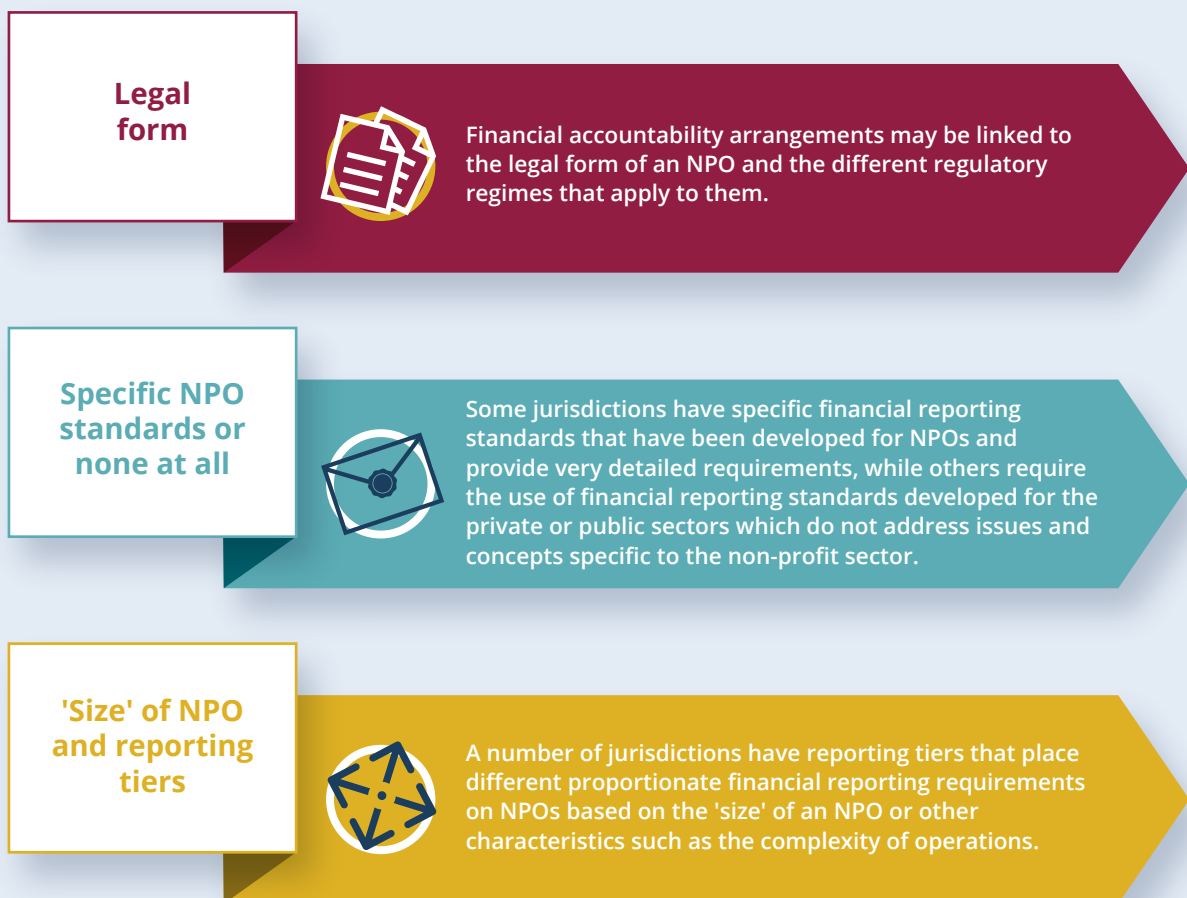
NPO's financial information will be more specific, with a greater focus on key financial indicators such as revenue and expenses, and how resources have been utilised on individual programmes.

- 2.20** The Guidance developed by the IFR4NPO project will assist in meeting the high-level information needs of most stakeholders. Its primary focus, however, will be on meeting the accountability and decision-making needs of users of NPOs' financial information and reports.
- 2.21** Existing financial accountability arrangements implemented by NPOs to meet user needs, and permit decision-making differ significantly globally. This is primarily a result of the different reporting requirements set by individual jurisdictions, but donor reporting requirements also vary significantly, and drive diversity.

Jurisdictional-level reporting requirements

- 2.22** NPOs are often required to submit formal financial information to jurisdictional authorities to comply with local taxation and other regulatory requirements. Where an NPO operates across borders it may be required to submit accounts in multiple jurisdictions. The applicable standards, format and content required can vary by jurisdiction. This diversity in financial accountability arrangements is driven by a number of factors as shown in Figure 2.3.
- 2.23** At a jurisdictional level, the consequences of this diversity include:
- An NPO operating in one jurisdiction may face significantly different reporting requirements to a similar NPO operating in another jurisdiction.
 - An NPO operating in a single jurisdiction may face significantly different reporting requirements to an NPO operating in the same jurisdiction that has a different legal form or is judged to be in a different reporting 'tier'.
 - NPOs that are registered in and/or operate in more than one jurisdiction may be required to comply with a number of different reporting regimes.
- 2.24** Individual jurisdictions make decisions on reporting requirements for NPOs based on characteristics such as legal form and with a view to ensuring proportionality. The IFR4NPO project can provide common financial reporting standards that address the issues and concepts specific to NPOs. This can support a reduction in diversity across jurisdictions.

Figure 2.3: Drivers of diversity in jurisdictional-level financial reporting requirements



Donor reporting arrangements

- 2.25** In contrast to jurisdictional requirements, donors are more likely to require NPOs to provide financial reports to demonstrate how resources have been utilised on individual projects and programmes they support. In the absence of common NPO reporting requirements these will be requested to meet their individual standards, formats and reporting periods. While individual project reports may continue to be required by donors, the Guidance can assist by establishing a consistent basis for these reports.
- 2.26** Many NPOs are increasingly operating in a global funding environment, and this is leading to a multiplicity of international grant and funding regimes. These grant and funding regimes bring with them a variety of accountability and decision-making arrangements, particularly with respect to how NPOs account for and report on the use of financial and other resources provided by donors.
- 2.27** As accounting and financial reporting arrangements for NPOs can vary significantly both between and within jurisdictions, it is difficult for those providing funding to NPOs to use and interpret the financial reports that NPOs prepare under these different arrangements. This may restrict the ability of donors to use these reports as part of the process to gain assurance that funding has been used in an economic and efficient way towards the purposes for which it has been provided. It also undermines the ability of donors to use these financial reports to compare the performance of different NPOs and ensure that their financial resources are directed to those entities which are most effectively achieving their objectives.
- 2.28** This is one factor behind the development by large donors in particular of their own financial reporting requirements. These have been developed independently by aid agencies and some philanthropic organisations primarily to meet their own accountability and decision-making requirements.¹⁰ Compliance with these by an NPO is usually a condition of the funding. An NPO that receives resources from multiple sources will therefore most likely have multiple differing donor reporting requirements.
- 2.29** The risk for an NPO with multiple donors is that there is a significant burden to producing financial reports for each donor, as well as meeting other financial and regulatory reporting required by individual jurisdictions. This can result in fewer resources being available for service delivery and increase the risk of

¹⁰ It must be recognised that donors themselves will be accountable to either the public or other stakeholders for the use of funds, including that resources provided to NPOs have been used in a proper manner. As such, detailed information on the use of funding may be sought not just to ensure that the funds provided have been spent on an individual project or programme. There may also be a need to demonstrate compliance with wider corporate governance and procurement standards for the donor, in order to give assurance to its stakeholders that funds have not been misused, or there is no potential for misuse.

reporting errors as NPOs look to meet the differing reporting requirements to which they are subject. There is also the risk that by focusing reporting on financial reports for donors, the needs of other external stakeholders and the broader requirements of societal accountability are not met.

- 2.30** While it is expected that donors will still in many cases continue to require NPOs to report directly to them, the IFR4NPO project can support a reduction in the reporting burden on NPOs. The use of common financial reporting standards will enable donors to make greater use of reports NPOs are producing for financial reporting and other regulatory purposes. It may also reduce the diversity in the different donor reporting requirements placed on NPOs if they can adopt these common standards.

Conclusion to Chapter 2: Who are NPO stakeholders and what are their needs?

- 2.31** This chapter has looked at NPO stakeholders and their accountability and decision-making requirements. External stakeholders need to know that an NPO is achieving its objectives, in a way that maximises economy, efficiency and effectiveness in the use of resources, while complying with restrictions and regulations, and in the context of its longer-term financial health.
- 2.32** Differences in reporting requirements at a jurisdictional-level mean that NPOs have to report using different standards and formats by jurisdiction. This has been a factor in donors imposing their own financial reporting requirements on NPOs. This has led to a significant additional reporting burden for NPOs as they are required to produce different financial reports.
- 2.33** This chapter provides important context that needs to be reflected in the development of a solution that improves financial reporting as anticipated in objective 1 and meets the needs of preparers and stakeholders as set out in objective 2.



General Matters for Comment 2

Chapter 2 has examined NPO external stakeholders, what information those external stakeholders need for accountability and decision-making purposes, and issues with current arrangements.

- 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 NPOs can be accountable to, and why?
- 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?
- 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?



Chapter 3: What are the essential aspects of NPO financial reporting guidance?

Chapter 3: What are the essential aspects of NPO financial reporting guidance?

3.1 Financial reporting frameworks are based on concepts that are aligned to their overall objectives. Concepts underpin the standards and other guidance within financial reporting frameworks to provide coherence. Similarly, NPO financial reporting Guidance needs to be developed using core premises aligned with the objectives of the Guidance:

Objective 1: To improve the quality, transparency and credibility of NPO financial reports.

Objective 2: To support the provision of NPO financial information that is useful for decision making and accountability, balancing the needs of preparers and users.

Objective 3: To address specific NPO issues, which will promote increased comparability of NPO financial reports.

3.2 Chapter 2 provided an overview of the high-level information needs of stakeholders and users of an NPO's financial information. These included requirements such as understanding the extent to which an organisation is achieving its objectives, abiding by regulations and restrictions, and has longer-term financial sustainability. This chapter explains the rationale for two core premises proposed for the development of NPO financial reporting guidance that are essential to meeting these stakeholder and user needs and the three Guidance objectives. These are:

- **accrual-based accounting** – which is internationally recognised as the best basis to provide a comprehensive view of an organisation's financial performance and position, improving the quality and transparency of financial reports and enhancing accountability and decision-making and
- **the inclusion of non-financial reporting information** – in order to provide context to financial information and additional information about the organisation's projects, programmes and wider activities required to meet broader stakeholder information needs.

The following sections discuss each premise and explain why they are necessary to meet the project objectives.

3.3 This chapter also describes common forms of financial reports used to demonstrate accountability and enable decision-making.

Accrual-based accounts

3.4 The basis of accounting is the method used to determine when economic events and transactions are recognised in the financial reports. The Guidance needs to have a single basis of accounting, so that financial reports are prepared on a consistent basis. There are three bases of accounting that are commonly used:

- **Cash**¹¹ – economic events and transactions are recognised when cash is received or paid. Assets and liabilities are not recognised.
- **Accrual** – economic events and transactions are recognised when the event occurs. This is when, for example, a service is provided and not when any related cash payments are made. Assets and liabilities are recognised.
- **Modified cash** – some economic events and transactions are recognised on a cash basis, but others may be recognised on an accrual basis. Some assets and liabilities may be recognised.

3.5 Each of these bases of accounting have advantages and disadvantages. Here additional information on their key features is provided before examining how they meet the objectives of the Guidance.

Cash basis accounting

3.6 Maintaining cashbooks for different bank, mobile money, and other cash accounts is the essential bedrock for all accounting. Cash accounting records transactions at the point when money is received and paid by an entity. Financial reports produced under cash accounting are usually a cashbook summary, often called a receipts and payments report. This shows the opening cash/bank balance, receipts by category, payments by category, and the closing cash/bank balance. Information on a cash basis at an individual programme or project level is often requested by donors and other stakeholders to understand how resources provided have been spent.

3.7 All organisations require effective controls over and accurate accounting for cash. Where financial reporting is based solely on cash, however, it is not possible to have a comprehensive view of the organisation's financial performance and position. Until a bill is paid for example, it will not show as an expense in the accounts. This impacts transparency, accountability and the decision-usefulness of cash-based financial reports.

¹¹ Note that cash does not just mean physical currency including notes and coins but also receipts and payments into entity bank or mobile money accounts as well.

Accrual basis accounting

- 3.8** Accrual accounting requires transactions and other economic events to be recorded when they occur as well as the recognition of assets and liabilities. This means that income and expenses are recorded when they are earned, when a service has been performed, or when a good has been provided – and not just when cash is received or paid. Accrual accounting also requires that money spent on assets like vehicles or buildings that will be used for many years is not included as a one-time expense, but instead the expense recognised over time to match the use of the asset. Other items that are not captured under cash accounting such as receivables (money the entity is owed) and payables (money the entity owes) are also recognised in the financial statements.
- 3.9** The extra financial information provided by accrual accounting processes means that as well as a statement that shows cash movements, there are additional financial reporting outputs. These include:
- a statement of financial performance (also known as an income and expense statement, profit and loss, or statement of financial activities) which shows revenue and expenses
 - a statement of financial position (also known as a balance sheet) that shows what an entity owns and what it owes.
- 3.10** These additional financial reporting outputs provide a comprehensive view of an organisation's financial performance and position. Transparency over the nature of costs and revenues, the assets over which the organisation has stewardship and that it relies on to deliver services, and the amounts it owes that need to be met from existing and future resources available to it, enhances accountability and decision-making.

Modified cash basis accounting

- 3.11** In between cash accounting and accrual accounting is the modified cash basis of accounting, where some transactions are recognised on a cash basis and some on an accrual basis. There is no single definition or generally accepted framework for the modified cash approach. It can take many different forms, with different decisions made about what is recognised on a cash basis and what is recognised on an accrual basis.

What is the appropriate basis for the Guidance?

- 3.12** Examining cash, accrual and modified cash accounting against the objectives of the Guidance, it is clear that for most entities, accrual has the greatest advantages and the least significant disadvantages.

Figure 3.1 Comparison of the different bases of accounts against the project objectives

| | Cash basis | Accrual basis | Modified cash basis |
|---|---|--|--|
| <p>Objective 1: To improve the quality, transparency, and credibility of NPO financial reports.</p> | Advantages | | |
| | <ul style="list-style-type: none"> • Easy to track receipts and payments related to individual projects or programmes. • Easiest basis of accounting for users to understand. | <ul style="list-style-type: none"> • Provides a comprehensive view of an entity's financial position and performance. • Information on the nature of costs, future payments, and resources due. • Can improve quality, reliability and integrity of financial information. | <ul style="list-style-type: none"> • Maintains easy to track elements of cash and adds understanding of some assets and liabilities. |
| | Disadvantages | | |
| | <ul style="list-style-type: none"> • Cannot provide information on overall financial performance and position. | <ul style="list-style-type: none"> • Needs access to technical accounting capacity and software if transactions are complex. • Users need to understand the information being provided. | <ul style="list-style-type: none"> • Incomplete picture of financial position and performance. • Lack of consistency in reporting. |
| <p>Objective 2: To support the provision of NPO financial information that is useful for decision making and accountability, balancing the needs of preparers and users.</p> | Advantages | | |
| | <ul style="list-style-type: none"> • May be preferred by donors most interested in tracking funding for specific projects and programmes. • Can be sufficient for less complex organisations, which do not have significant assets or liabilities. • Usually less resource intensive to produce. | <ul style="list-style-type: none"> • Knowledge of what is owned, asset condition and how assets are used. • Better management of cash with visibility of the commitments from past events. • Better able to hold management to account and make informed funding and other decisions. | <ul style="list-style-type: none"> • Can improve the information provided on assets and liabilities depending on which are recognised. |
| | Disadvantages | | |
| | <ul style="list-style-type: none"> • Less able, and potentially less incentive, to manage assets and liabilities. • May prevent the formation of a long-term view of the entity's financial viability. | <ul style="list-style-type: none"> • Can be more resource intensive to produce financial reports. • Additional information is useful only if understood by stakeholders. | <ul style="list-style-type: none"> • Creates an incomplete picture of financial position and performance, which may impact on the operational and financial decisions. |
| <p>Objective 3: To address specific NPO issues, which will promote the comparability of NPO financial reports.</p> | Advantages | | |
| | <ul style="list-style-type: none"> • Can accommodate some individual specific stakeholder needs. | <ul style="list-style-type: none"> • Can address all key NPO-specific issues. • Improve comparability by requiring recognition of all relevant transactions and economic events. | <ul style="list-style-type: none"> • Some NPO-specific issues may be addressed depending on which assets and liabilities are recognised. |
| | Disadvantages | | |
| | <ul style="list-style-type: none"> • Will not address all key NPO-specific issues. • Comparability harmed as timing is likely to lead to differences in financial reports. | <ul style="list-style-type: none"> • Options for different treatments permitted in accounting standards can reduce comparability between entities. • Requires increased use of judgement, which can increase compliance costs. | <ul style="list-style-type: none"> • Will not address all key NPO-specific issues. • Comparability harmed as not all accrual information in financial reports. |

- 3.13** Figure 3.1 shows that the additional information accrual accounting can provide improves the quality and transparency of financial reports. Accrual accounting is also best able to address NPO-specific issues and improve comparability. This recognises the balance between the cost of producing accrual-based financial information and the significant benefits to the users of this information for accountability and decision-making purposes. To meet the needs of external stakeholders and users and deliver the project objectives, the use of accrual is therefore the most appropriate basis for common financial reporting. This is therefore the first core premise.
- 3.14** For less complex NPOs, the cash or modified cash basis and primarily cash-based accountability and decision-making arrangements may be appropriate to meet the needs of external stakeholders. For such entities, the disadvantages of accrual accounting such as the extra resources required to produce accrual based financial reports can outweigh the benefits of the additional information provided.
- 3.15** It is also recognised that cash and modified cash-based information may continue to be required by large donors to understand the utilisation of funding provided for specific projects or programmes. Increasing the confidence of this stakeholder group in using accrual based financial reports where these can support the meeting of their needs will be important if the reporting burden on NPOs is to be lessened.

Non-financial reporting information

- 3.16** Management commentary and forms of other narrative reporting that comprise non-financial reporting information are also important for demonstrating accountability and providing decision-useful information. Such reporting encompasses additional information that is provided to supplement and complement the financial statement information. This might include areas such as an entity's nature, objectives, strategy, risks, and the impact of the entity's projects, programmes and wider activities.
- 3.17** Non-financial information is arguably as relevant, if not more so, for NPOs than for other organisations. Providing a wide range of non-financial information and measures helps stakeholders improve their understanding of an NPO and its performance in relation to its primary objectives. Where service delivery for public benefit is so important, this information could provide a clearer indication of how well an NPO is achieving these non-financial objectives. It could also provide stakeholders with information on areas such as the use and importance of volunteer contributions of time that may not be captured in the financial statements alone but upon which an NPO is reliant.

- 3.18** Currently, requirements to include non-financial information in NPO financial reports vary within and between jurisdictions, with disclosure requirements based on local accounting, regulatory, and legislative requirements. Some jurisdictions have no requirement for non-financial information.
- 3.19** There can be valid reasons for these differences. Differential non-financial information reporting requirements could, for example, reflect the greater degree of accountability to society and stewardship reporting required of larger NPOs, compared with the more local accountability needs of smaller, community based or similar NPOs.
- 3.20** In general, however, a lack of consistency in reporting requirements can lead to external stakeholders not having access to the information they require, and difficulties in comparing the performance of NPOs that are subject to different reporting regimes.
- 3.21** Consistency in the requirement to include non-financial information would benefit stakeholders by providing additional information that might be useful for accountability and decision-making purposes. For users of NPO financial reports, it would deliver transparency and improve credibility, and allow comparison between NPOs. For these reasons, the inclusion within the Guidance of principles related to non-financial reporting information is the second core premise.

What are the different types of financial report that NPOs may produce?

- 3.22** There are three main approaches to providing reports to external stakeholders to demonstrate accountability and enable decision-making.

Special purpose financial reports

- 3.23** The term 'special purpose financial reports' includes any form of financial statement or financial report that is produced to meet the specific needs and requirements of an individual external stakeholder. They are produced in accordance with standards, formats and reporting periods and currencies set by the external stakeholder. In the context of NPOs they usually provide financial information on individual projects and programmes, rather than for the entity as a whole.
- 3.24** As each special purpose financial report is produced in accordance with the requestor's requirements, they can be resource intensive to produce. This can demand significant resources when an entity has many external stakeholders with varying individual requirements.

General Purpose Financial Statements

- 3.25** General Purpose Financial Statements comprise a single financial report, including a number of defined financial statements produced using a common set of standards, usually on an annual financial year basis. They provide external stakeholders who are unable to require the production of special purpose financial reports with information about what an entity owns and owes, its income and expenses, and how it is financed. They are often used for regulatory purposes.
- 3.26** The standards used in producing General Purpose Financial Statements are usually set by the authorities in the jurisdiction in which the entity is based. Jurisdictions are likely to have their own standards, formats and reporting periods. Where an entity operates in more than one jurisdiction it may have to produce more than one set of General Purpose Financial Statements. Producing these reports may be less resource intensive where they reduce the need to produce financial reports for specific stakeholders.

General Purpose Financial Reports

- 3.27** General Purpose Financial Reports are often called 'annual reports', and present management commentary and other narrative reporting alongside the financial information contained in the General Purpose Financial Statements. They are intended to provide users with a more meaningful understanding of an entity's nature, objectives, strategy, risks, and performance. When used effectively, management commentary and other narrative reporting provide a range of performance measures and indicators consistent with underlying financial information. This can provide a clearer view of the impact of the entity's projects, programmes and wider activities on stakeholders. Further information is in Figure 3.2.

Figure 3.2 Advantages of General Purpose Financial Reports

The objective of general purpose financial reporting is to provide information that is useful for accountability and decision-making purposes to those users who do not possess the authority to require an entity to prepare and disclose information to meet their specific needs.

General Purpose Financial Reports are therefore intended to provide a single annual report that includes audited financial information to meet the greatest common needs of the key users of that financial information.

In the private sector, General Purpose Financial Reports are aimed at meeting the needs of investors. In the public sector, General Purpose Financial Reports are aimed at meeting the needs of citizens (as both service users and taxpayers) and the government, and for the non-profit sector General Purpose Financial Reports should meet the needs of relevant stakeholders as set out in Chapter 2.

General Purpose Financial Reports are more comprehensive than General Purpose Financial Statements. General Purpose Financial Statements comprise the balance sheet, income statement, statement of changes in equity, and cash flow statement and provide information about an entity's assets, liabilities, equity, income and expenses that is useful to financial statement users when assessing prospects for future net cash inflows to the entity and management's stewardship of the entity's resources.

General Purpose Financial Reports include not only the General Purpose Financial Statements but also non-financial information, so providing users with integrated information that provides context for the financial statements and complements and supplements them through discussion of issues, such as:

- the nature of the entity's business
- its objectives and strategies
- resources, risks and relationships
- results and future prospects
- the performance measures and indicators used to manage the business.

- 3.28** Producing General Purpose Financial Reports significantly improves the usefulness of the financial and non-financial information provided to external stakeholders. General Purpose Financial Reports have the potential to reduce funders' demand for Special Purpose Financial Reports, enabling NPOs to demonstrate accountability while reducing the burden of having to report to external stakeholders in different formats and to different standards. They can also enable those external stakeholders to make decisions by being able to compare the financial and non-financial performance of the entity over time and against other entities more easily.
- 3.29** As with General Purpose Financial Statements, if an entity operates in more than one jurisdiction an NPO may have to produce a General Purpose Financial Report for each jurisdiction to meet their individual standards, formats and reporting periods.
- 3.30** Naturally, the scale and complexity of an NPO's activities will impact on the amount and form of information needed to demonstrate accountability and for decision-making purposes. For more complex NPOs, there will be a need for additional transparency and more sophisticated arrangements. General Purpose Financial Reports that provide both financial and non-financial information are, however, inherently more likely to meet the needs of external stakeholders for accountability and decision-making purposes.

Conclusion to Chapter 3: What are the essential aspects of NPO financial reporting guidance?

- 3.31** Accrual-based financial information is best able to meet the financial information needs of a wide range of NPO stakeholders. It provides a more comprehensive view of an entity's financial position and performance than either cash-based or modified cash-based information. It improves the information that can be used to hold management to account and make funding and other decisions.
- 3.32** General Purpose Financial Reports that include non-financial information can best meet the common information needs of stakeholders. Reports that include non-financial information can provide the additional context needed for accountability and decision-making purposes, such as an understanding of an entity's objectives, strategy, risks, and performance. Such information is not provided by either General Purpose Financial Statements or Special Purpose Financial Reports, although Special Purpose Financial Reports can provide information on areas like utilisation of funding for projects and programmes that are generally not included in General Purpose Financial Reports.

- 3.33** Use of accrual-based financial information and General Purpose Financial Reports that reflect the needs of stakeholders will also allow the three overall project objectives to be met. Chapter 4 examines how international accounting standards and guidance are able to support the objectives of the project.



General Matters for Comment 3

Chapter 3 explains the two key premises for developing the Guidance so that it supports the provision of information that is useful for accountability and decision-making.

- 3.a** What, if any, do you see as the main challenges with Guidance that is accrual-based?
- 3.b** What, if any, do you see as the main challenges with Guidance that includes non-financial information reporting?



Chapter 4: How far can existing international financial reporting frameworks assist NPOs?

Chapter 4: How far can existing international financial reporting frameworks assist NPOs?

4.1 Chapter 3 proposed that the project guidance objectives can be met if the Guidance is accrual-based and requires non-financial reporting information. These objectives are:

Objective 1: To improve the quality, transparency and credibility of NPO financial reports.

Objective 2: To support the provision of NPO financial information that is useful for decision making and accountability, balancing the needs of preparers and users.

Objective 3: To address specific NPO issues, which will promote the comparability of NPO financial reports.

4.2 There are three existing international financial reporting frameworks that are accrual-based and support the provision of non-financial information. These are IFRS Standards, IPSAS, and within the IFRS suite of standards, the *IFRS for SMEs* Standard. There are a number of accrual-based individual jurisdictional-level frameworks and these also provide some broader guidance on management commentary and other narrative reporting. If existing financial reporting standards can be harnessed the Guidance could be developed more rapidly.

4.3 This chapter develops the argument for why the Guidance needs to be based primarily on an international rather than jurisdictional-level framework. It examines the extent to which the three existing international frameworks would allow the project objectives to be met, and therefore whether they might be suitable as a basis for the Guidance. A high-level assessment also considers the extent to which NPO-specific reporting issues are already addressed by current international standards.

International applicability

4.4 The absence of NPO-specific guidance in many jurisdictions, and the different approaches taken in those jurisdictions where guidance has been developed, means that around the world NPOs are applying different accounting standards and policies to similar economic events and transactions regardless of the basis of accounting. For example, different approaches to recognising income can mean that one NPO recognises grant income when it becomes receivable, another when the cash related to the grant has been received, and a third only to the extent that it has spent the grant.

- 4.5** In many jurisdictions there is no specific NPO guidance or, where NPO guidance does exist, it closely mirrors existing approaches to the for-profit private sector, public sector reporting or a mixture of the two without adequately taking into consideration the NPO context.
- 4.6** A limited number of jurisdictions have taken a more NPO-focused approach to the development of guidance, using a variety of sources, including international standards and jurisdiction specific accounting standards that apply to other sectors. Where jurisdictional-level guidance has been derived from international frameworks, this generally reflects a similar conceptual basis to those frameworks. The guidance though, as would be expected, is usually aimed at providing reporting solutions to meet that individual jurisdiction's specific needs, rather than with a view to international applicability.¹² It is also developed within jurisdictional-level due process and is not subject to full international consultation.
- 4.7** If transparency, consistency and comparability of reporting is to be improved, it is essential that a single set of Guidance is developed that can be applied within and across jurisdictions globally. While the Guidance could be developed from an existing individual jurisdiction's NPO guidance, regulators may be better able to consider adopting the Guidance if it is designed to be internationally applicable rather than to meet an individual jurisdiction's needs, and if it has consistency with international accounting standards in other sectors. This would increase its commonality and allow it to draw on robust international accounting standard setting due process rather than that of an individual jurisdiction.

Project delivery and the use of existing jurisdictional-level and international frameworks

- 4.8** A solution to the problems facing NPOs and their external stakeholders needs to be developed on a timely basis. Developing a new set of standards for NPOs is not feasible within the timeframes of the project and the sector cannot wait decades.¹³ Further, the financial and human resources that would be needed to develop a separate full suite of international standards for NPOs is not currently available to the IFR4NPO project. These limitations on time and resource mean that the Guidance must necessarily draw on existing frameworks.
- 4.9** The Guidance will need to provide a coherent suite of financial reporting standards for NPOs. While the development of the Guidance will initially be

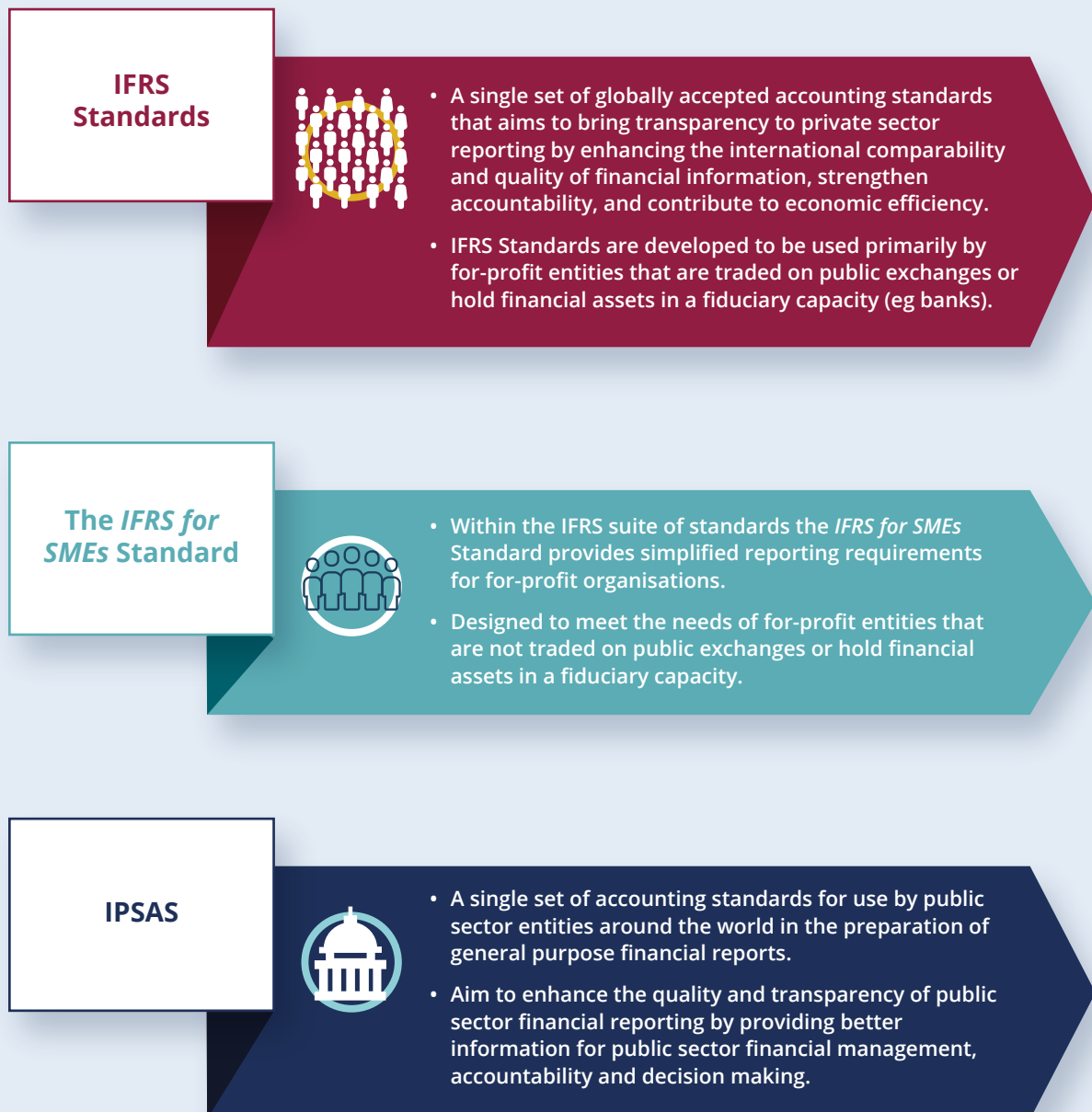
¹² Further detail on jurisdictional-level guidance is included in Supplementary Information: International and national financial reporting standards and guidance.

¹³ By way of comparison, it has taken the International Public Sector Accounting Standards Board (IPSASB) more than 20 years and significant resources to develop its conceptual framework and an increasingly complete set of financial reporting standards for use by public sector entities.

focused on providing solutions for a range of NPO-specific financial reporting issues, the framework(s) on which the Guidance is based needs to cover all of the main economic events and transactions for which NPOs need to account, not just those where NPO-specific solutions are necessary.

- 4.10** Jurisdictional-level reporting frameworks can provide important supplementary sources for the Guidance. However, for the reasons noted in paragraphs 4.4–4.7, they are not proposed to be the primary frameworks on which the Guidance will be based.
- 4.11** Instead the Guidance is proposed to be based primarily on one of the international reporting frameworks that provide international, accrual-based financial reporting standards with some additional guidance on narrative type reporting.
- 4.12** IFRS Standards are primarily for use by private sector entities that are listed on a public exchange (eg stock market) or hold financial assets in a fiduciary capacity (financial institutions). The *IFRS for SMEs* Standard is aimed at those private sector entities that do not have such accountability.
- 4.13** The *IFRS for SMEs* Standard is a self-contained Standard that is less complex than full IFRS Standards (and many national GAAPs) in a number of ways, including:
- 250 pages compared with over 2,000 pages of text in the full IFRS Standards suite
 - Topics not relevant for SMEs are omitted
 - Many recognition and measurement requirements are simplified
 - Significantly fewer disclosure requirements (c.90% reduction)
 - The Standard is written in clear, easily translatable language
 - To reduce compliance burdens, revisions are less frequent.
- 4.14** IPSAS have been developed to meet the reporting needs of public sector entities, but alignment where appropriate with IFRS Standards has always been a key pillar of the IPSAS development process. A formal alignment process exists to ensure the differences between the IFRS Standards and IPSAS financial reporting standards are only those needed to address the specific needs of the public sector. In many instances government and corporate activities are the same and there are clear advantages of using common global financial reporting approaches. These include making financial statements easier to understand for users when similar economic events and transactions are accounted for and reported in the same way by both public and private sector entities.

Figure 4.1: The three international financial reporting frameworks



- 4.15** IFRS and IPSAS are each underpinned by their own conceptual frameworks, although there are many concepts in common. The *IFRS for SMEs* Standard is aligned to the IASB's conceptual framework for IFRS. Both conceptual frameworks describe the objective of general purpose financial reporting alongside the key concepts to the development and interpretation of standards.
- 4.16** Comparison of the IASB's and IPSASB's conceptual frameworks reveals many similarities, including the definition of a reporting entity, the elements of financial statements, and recognition and presentation principles.¹⁴ The differences primarily reflect the different purposes of entities in the private and public sectors. In particular, there are differences in concepts around measurement. For example, many assets are held by public sector entities to deliver public services rather than to generate economic or financial returns and this is reflected in the measurement bases available. The impact of these differences will be highlighted when examining NPO-specific reporting issues later in this chapter.
- 4.17** These international frameworks have been developed through thorough, transparent and participatory due processes that have global acceptance.¹⁵ They include public exposure and consultation on any new standards or proposed changes to standards.
- 4.18** The IFRS Foundation has previously acknowledged a need for standardised reporting for NPOs and the need for transparent financial reporting requirements for the sector. However, to date, the remit of IFRS has not been widened to cover NPOs, although the trustees of the IFRS Foundation have stated that they continue to "support the need for transparent financial reporting requirements of not-for-profit bodies."¹⁶
- 4.19** The International Public Sector Accounting Standards Board (IPSASB®) has more limited resources than the IFRS Foundation and its standards development programme is at an earlier stage. With pressure to address the remaining needs of the public sector, any extension of its remit to address NPO-specific issues is unlikely.
- 4.20** Although neither IFRS Standards, the *IFRS for SMEs* Standard nor IPSAS are developed with NPO financial reporting needs in mind, between them they address many similar issues. Using these existing frameworks as a basis for NPO financial reporting could harness their respective hierarchies, structures and legitimacies and provide credibility to the Guidance produced. For these

¹⁴ See the Supplementary Information: international and national financial reporting standards and guidance for a detailed comparison of the two conceptual frameworks.

¹⁵ Further details on these processes can be found in the Supplementary Information: International and national financial reporting standards and guidance.

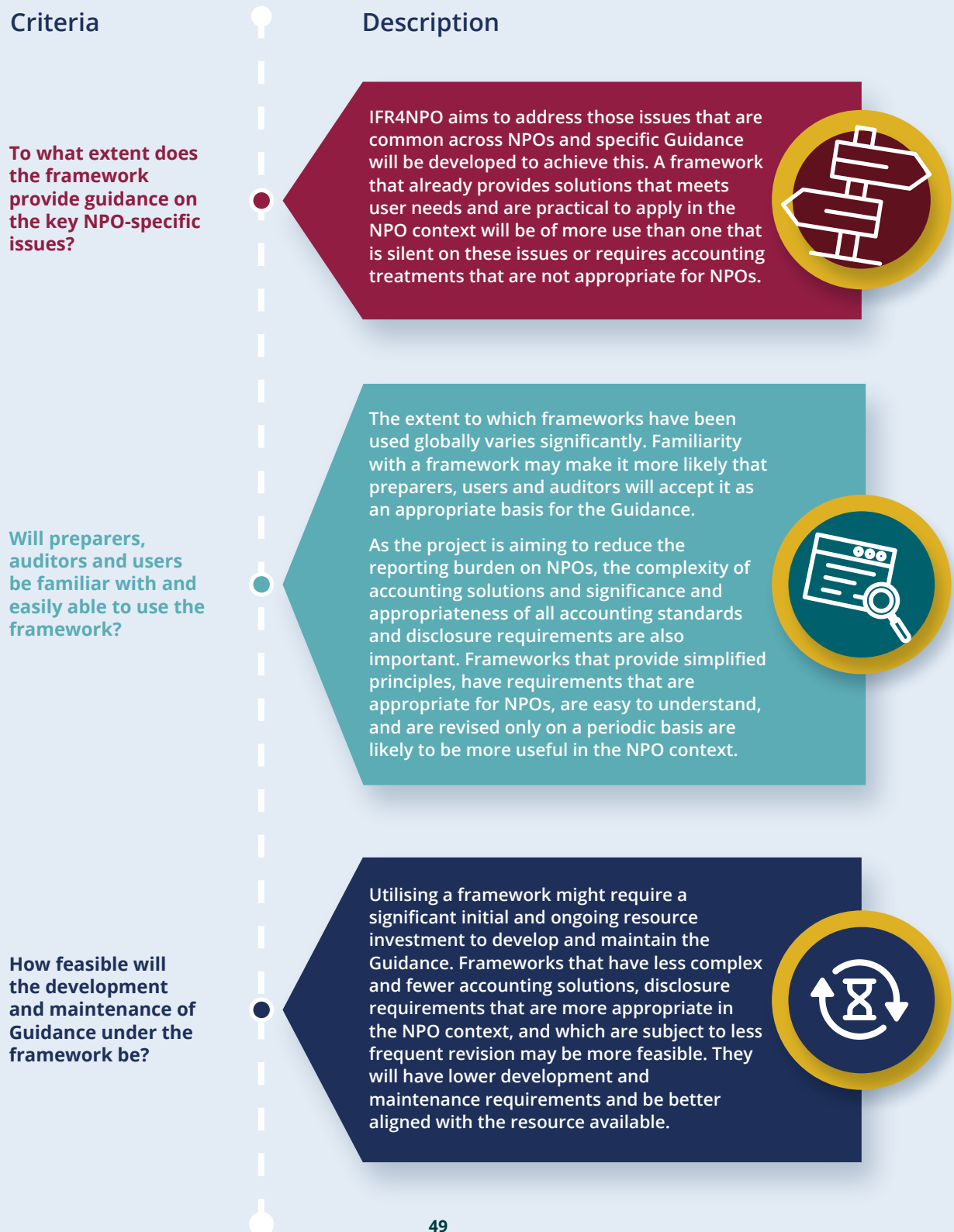
¹⁶ <https://cdn.ifrs.org/-/media/project/2015-trustees-review/request-for-views/educational-materials/feedback-statement-request-for-views.pdf>

reasons it is proposed to use international frameworks as the primary basis of the Guidance.

Criteria for evaluating the suitability of international frameworks as a basis for NPO Guidance

- 4.21** As the international financial reporting frameworks have acceptance as high-quality financial reporting frameworks the criteria used to evaluate these frameworks are focused on other aspects of the project Guidance objectives. Three criteria are proposed to evaluate the suitability of these frameworks as a basis for the development of the Guidance as set out in Figure 4.2.

Figure 4.2 Criteria for evaluating the suitability of international frameworks as a basis for NPO Guidance



Assessment of extent of NPO-relevant guidance provided by international financial reporting frameworks

4.22 To assess the extent of guidance on key NPO-specific issues provided by each international framework, the issues outlined in Part 2 to this document have been considered. The Overview to Part 2 provides information on the list of issues and why they have been included. Further information about these sources is available in the Supplementary Information: Additional project information.

4.23 Figure 4.3 contains a high-level description of some of the key NPO-specific issues and summarises the applicability to NPOs of existing standards under full IFRS Standards, the *IFRS for SMEs* Standard and IPSAS. A fuller assessment can be found in Supplementary Information: Analysis of NPO-specific issues against international standards.

Figure 4.3: Relevance of guidance provided by international frameworks to NPO-specific issues

| Relevance of existing international standards to the key NPO-specific reporting issues | Rating |
|---|---------------|
| The framework does not provide guidance relevant to the key NPO-specific reporting issues | |
| The framework provides some guidance relevant to the key NPO-specific reporting issues | |
| The framework provides a range of guidance relevant to the key NPO-specific reporting issues | |

| Category | IFRS Standards | The IFRS for SMEs Standard | IPSAS |
|--|-----------------------|-----------------------------------|--------------|
| Accounting for incoming resources | | | |
| Accounting for outgoing resources | | | |
| Accounting for non-financial assets | | | |
| Reporting entity | | | |
| Form and content of financial reports | | | |

4.24 This analysis shows that none of the frameworks address all the key NPO-specific issues, although there are many areas where existing guidance could potentially be utilised in the NPO context. IPSAS performs better overall, particularly in areas related to non-exchange transactions and accounting for assets that are held for the services they can provide rather than for cash generation.

Assessment of international financial reporting frameworks against familiarity and ease of use

- 4.25** The requirements of full IFRS Standards are complex, both in terms of the accounting principles that the standards require and the associated disclosure requirements. NPO preparers would need to understand the requirements of all of the standards. They would also have to make judgements about whether the standards apply to them, particularly where the transactions that might be covered by a standard are insignificant to an NPO. NPOs would need to place reliance on this concept of materiality to determine if a standard needs to be applied and the extent of any disclosures. This would lead to greater work by NPOs and for their auditors.
- 4.26** IFRS Standards are widely used across the world. Of 166 jurisdictions that have been profiled by the IFRS Foundation, 144 require IFRS Standards for all or most domestic publicly accountable entities. As full IFRS Standards are mainly used by relatively few, larger private sector entities, this will not automatically translate into familiarity for NPO preparers, auditors and users. Among smaller or less complex NPOs, it is unlikely that preparers and auditors will have regularly operated with or be familiar with the requirements of full IFRS Standards.
- 4.27** The *IFRS for SMEs* Standard omits accounting topics irrelevant for non-listed entities and accounting options are reduced. As it is written in clear, easily translatable language, ease of use is improved. Also, the entire standard is not reviewed on average more than once every five years, providing stability so that users can grow familiar with the requirements.
- 4.28** However, gaps in NPO-specific topic coverage may lead to NPOs having to create their own interpretations, which impact ease of use. Furthermore, the disclosure requirements of the *IFRS for SMEs* Standard may not always be appropriate in the NPO context given that these entities are likely to have different accountability requirements, including a broader accountability to society.
- 4.29** The IFRS Foundation advises that 86 jurisdictions require or permit the use of the *IFRS for SMEs* Standard, with a further nine currently considering its application. These include jurisdictions such as the UK that have developed financial reporting standards using the *IFRS for SMEs* Standard at their core. The IFRS Foundation estimate that approximately 95% of all entities are SMEs under the IFRS definition, so although not used in as many jurisdictions as full IFRS Standards, familiarity with the *IFRS for SMEs* Standard could be higher than the comparison of jurisdiction figures suggests. However, the IFRS Foundation figures also demonstrate a large number of jurisdictions that require IFRS Standards for private sector entities traded on public exchanges or that hold financial assets in a fiduciary capacity, use national standards for other entities.

- 4.30** IPSAS are less widely used than the other frameworks at present, reflecting the relatively low use of accrual accounting by governments and public sector entities globally. Recent figures indicate that of the 37 governments that currently report on accrual, 19 (51%) are using IPSAS either directly, indirectly or as a basis for their own national standards. A large number of governments are currently transitioning to accrual accounting. The 2018 International Public Sector Financial Accountability Index¹⁷ published by IFAC and CIPFA estimates that of the 98 governments projected to be reporting on accrual by 2023, 72 (73%) will be making use of IPSAS.
- 4.31** The same complexity issues that exist with IFRS Standards are relevant, both in terms of the accounting principles that the IPSAS standards require and their associated disclosure requirements. Ease of use by NPOs may also be impacted by an absence of 'IPSAS for SMEs' to provide simplified reporting requirements where this is appropriate. However, as many of the individual IPSAS standards are closely aligned to IFRS Standards, it is only the standards that deal specifically with public sector specific issues, such as revenue from non-exchange transactions, that will be different and maybe less familiar.
- 4.32** It is recognised that familiarity with international standards is likely to be mixed across the world. However, the concepts that underpin IFRS Standards, the *IFRS for SMEs* Standard and IPSAS are often in use to a greater or lesser extent in a large number of jurisdictions. Globally, it is expected that more jurisdictions will be familiar with international standards than national frameworks developed in individual jurisdictions.
- 4.33** This analysis shows that there may be challenges associated with each of the frameworks. However, the *IFRS for SMEs* Standard, being a single standard designed to meet the needs of a broad range of entities that has been written in plain English and is aligned to the conceptual framework for IFRS, offers significant advantages.

Assessment of international financial reporting frameworks against feasibility of developing and maintaining the Guidance

- 4.34** Full IFRS Standards have different accounting options available in a number of standards as well as extensive disclosure requirements. It is subject to an ongoing process of change, with frequent updates for new standards or amendments to existing standards.
- 4.35** This drives complexity and, with potentially frequent changes, would necessitate a significant amount of work to develop guidance. A process of ongoing monitoring for the interpretation and adaption of standards would

¹⁷ www.ifac.org/knowledge-gateway/supporting-international-standards/discussion/international-public-sector-financial-accountability-index

also be needed to assess the impact on the NPO context. Use of the full suite of IFRS Standards would therefore necessitate the investment of significant resource initially and on an ongoing basis to ensure the development and maintenance of the Guidance was consistent with the underlying framework.

- 4.36** IPSAS is similar as it is also complex, has significant disclosure requirements and is subject to ongoing development and updates. This is partly as a result of maintaining alignment with IFRS Standards where appropriate and also due to the ongoing development of public sector specific standards. Use of IPSAS would have similar development and maintenance implications to full IFRS Standards.
- 4.37** The *IFRS for SMEs* Standard is a simplified framework that is updated on average every five years or so, with requirements that are not relevant removed or tailored to meet the needs of smaller entities. Developing initial guidance from a standard that is approximately 250 pages as opposed to the approximately 2,000 pages that comprise full IFRS Standards or IPSAS would be easier. Once the Guidance is developed, it would not need to be subject to continual monitoring and update because, although the *IFRS for SMEs* Standard is currently undergoing a comprehensive review, updates to the *IFRS for SMEs* Standard are periodic rather than continual. This would be expected to reduce the resource required to develop and maintain the Guidance.

Conclusion to Chapter 4: How can international financial reporting frameworks assist NPOs?

- 4.38** Limitations on time and resource available to the IFR4NPO project mean that the Guidance must be based on existing frameworks. These can potentially be either those that are applied in individual jurisdictions or one of three international reporting frameworks.
- 4.39** Jurisdictional-level frameworks are not expected to have been developed with international application in mind and are subject to jurisdictional-level rather than international due process. An approach based primarily on international standards is therefore proposed to harness their respective hierarchies, structures and legitimacies and provide credibility to the Guidance produced. Jurisdictional-level frameworks, particularly where they draw on these same international standards, can, however, remain important sources when developing the Guidance.
- 4.40** Guidance that has common features with other international accounting standards and can be applied internationally could reduce the demand and burden on NPOs, by eliminating the need to produce different sets of accounts for regulators in different jurisdictions. It could also improve the usability of financial reports by providing an international solution to a broad range

Chapter 4: How far can existing international financial reporting frameworks assist NPOs?

of financial reporting issues that will benefit a broad range of NPO external stakeholders.

- 4.41** The three existing international frameworks have similar conceptual bases but also key differences. When assessed against suitability criteria, each of the international frameworks display their own different potential benefits and issues as a basis for the Guidance.
- 4.42** All of the frameworks would enable objective 1 to be met. However, no single existing international framework performs well across all criteria and allows the remaining two objectives to be met. Objective 2 could be met by all three frameworks if adapted to the specific needs of users of NPO financial reports. None of the frameworks would allow objective 3 to be fully met, unless additional NPO-specific guidance was included.
- 4.43** Chapter 5 therefore develops a proposed way forward designed to meet all of the objectives of the IFR4NPO project Guidance.



General Matters for Comment 4

Chapter 4 has highlighted 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.

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



Chapter 5: Proposed way forward

Chapter 5: Proposed way forward

- 5.1** Chapter 4 examined the options for utilising international frameworks to develop the Guidance. Analysis of these frameworks against criteria linked to the project Guidance objectives demonstrates that no single existing international framework is suitable on its own. In particular, none of the frameworks performs well against the criteria linked to Objective 3: *To address specific NPO issues, which will promote the comparability of NPO financial reports.*
- 5.2** Chapter 5 develops a way forward to meet all of the project Guidance objectives. It proposes a model that takes account of the analysis in Chapter 2 of the accountability and decision-making arrangements in the sector, and the analysis in Chapter 4 of the international frameworks and jurisdictional-level standards that the Guidance could draw on.
- 5.3** To meet the project timeframes the Guidance is not likely, initially, to be able to meet the needs of all NPOs. This chapter also proposes therefore that while being of use to all NPOs, the Guidance initially focuses on NPOs that have more complex reporting requirements.

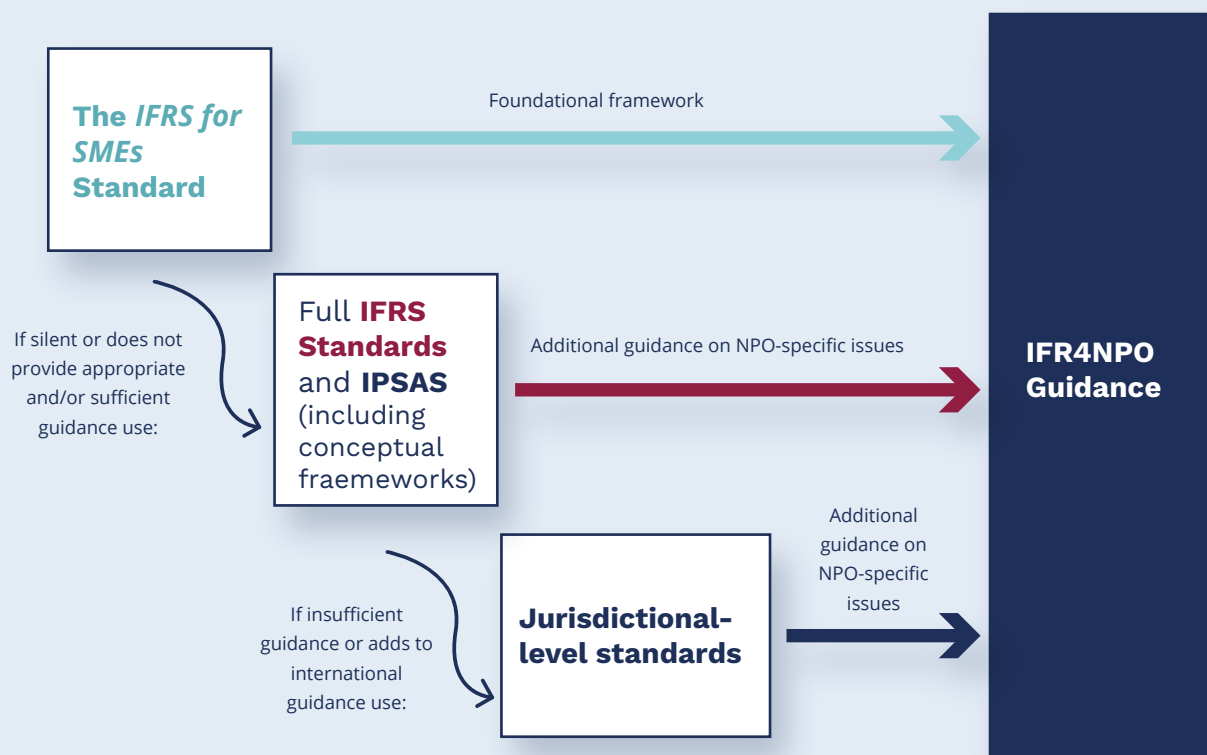
Proposed Guidance model

- 5.4** As none of the international or jurisdictional-level frameworks provide an adequate standalone solution, a proposed model where aspects of different frameworks are brought together as a source for the Guidance has been developed.
- 5.5** The *IFRS for SMEs* Standard is suggested as the foundational international framework for this model on the basis that it:
- provides a shorter, simplified standalone Standard with reduced disclosure requirements compared with IPSAS or full IFRS Standards, and accounting requirements that are expected, in most cases, to be appropriate for the NPO context
 - is aligned with the full IFRS Standards including the conceptual framework and developed in compliance with the IFRS Foundation's due process requirements
 - may have an acceptable level of familiarity and acceptance amongst regulators, preparers, auditors and users internationally
 - is the most feasible solution as it would require the lowest level of initial and ongoing resource to develop and maintain the Guidance.
- 5.6** Where the *IFRS for SMEs* Standard is silent on NPO-specific reporting issues or does not otherwise provide appropriate and/or sufficient guidance, the proposed model would draw on IPSAS, full IFRS Standards, and their broader

conceptual frameworks to develop sector-specific reporting solutions. IPSAS may be particularly useful in relation to those transactions that are for social benefit rather than for profit.

- 5.7** The proposed model would also draw on jurisdictional-level standards to address remaining coverage gaps, particularly where they have been developed in a manner that is sufficiently consistent with the conceptual framework of IFRS Standards and/or IPSAS. Some jurisdictional-level standards already provide interpretations or guidance based variously on the *IFRS for SMEs* Standard, IPSAS and IFRS Standards as well as specific standards and/or guidance based on local GAAP. These may be useful in developing the Guidance, where local interpretations add to international guidance or where there is no content in the existing international frameworks.
- 5.8** This approach may be particularly useful in considering NPO-specific user needs. This could, for example, include disclosure requirements that differ from those for the for-profit private and public sectors and are tailored to the needs of the users of NPO general purpose financial reports.
- 5.9** The IFR4NPO Guidance under this proposed model will provide a full suite of financial reporting standards for NPOs. Where there is no requirement for a sector specific reporting solution and the *IFRS for SMEs* Standard provides appropriate and sufficient guidance, the *IFRS for SMEs* Standard will apply directly. Where a sector specific solution is required, the Guidance will utilise full IFRS Standards, IPSAS and/or jurisdictional-level standards as appropriate in line with the proposed model.

Figure 5.1: Proposed Guidance model



Assessing the proposed Guidance model against the criteria

5.10 In Chapter 4, the international frameworks were assessed against three criteria. The same criteria have been used to assess the proposed Guidance model:

Figure 5.2: Comparing use of a single international framework against the proposed Guidance model

| Single international framework | Proposed Guidance model |
|--|--|
| To what extent does the framework provide guidance on the key NPO-specific issues? | |
| No single international framework provides guidance on all the sector specific issues identified, although IPSAS is stronger in areas where transactions are for social benefit rather than for profit. | Inclusion of full IFRS Standards, IPSAS and jurisdictional-level standards will allow the model to utilise the standards from different conceptually similar frameworks to provide guidance to sector-specific issues. |
| Will preparers, auditors and users be familiar with and easily able to use the framework? | |
| Familiarity with full IFRS Standards and IPSAS by NPOs will be limited, and these are complex standards with extensive disclosure requirements. Potential for the <i>IFRS for SMEs</i> Standard to be more familiar particularly if it has been incorporated into local GAAP and the framework is designed to be easier to use. | By using frameworks that share a conceptually similar basis, familiarity will be increased. Omitting irrelevant accounting topics for NPOs and appropriate reductions in accounting options and disclosure requirements will also support ease of use. |
| How feasible will the development and maintenance of Guidance under the framework be? | |
| Complexity and frequency of change of full IFRS Standards and IPSAS would necessitate a significant amount of initial work and a process of monitoring for the interpretation and adaption of standards for the NPO context. The <i>IFRS for SMEs</i> Standard is a simplified framework and subject to more limited periodic revisions so initial and ongoing resource to develop and maintain the Guidance would be reduced. | Utilising the <i>IFRS for SMEs</i> Standard as the foundational framework is expected to limit the initial and ongoing resource required to develop and maintain the Guidance. Where full IFRS Standards, IPSAS and jurisdictional-level standards are used, timing differences and changes to these frameworks will need to be monitored to ensure material inconsistencies do not develop. |

- 5.11** The proposed Guidance model performs better overall against the criteria than any individual international framework as it will:
- ensure that the Guidance covers the key NPO-specific issues when no single international framework does
 - maximise familiarity and ease of use of the Guidance by using frameworks with a shared conceptual basis and having a foundation of sector appropriate reductions in accounting options and disclosures
 - limit both the initial and ongoing resources needed for the Guidance to be developed and maintained.
- 5.12** Two potential issues that can be raised with the proposed Guidance model are conceptual coherence and timing differences between framework and source guidance updates. On conceptual coherence, there are differences between the objectives of financial reporting on which IFRS Standards and IPSAS are based, but in most respects they are similar¹⁸. Aspects such as the reporting entity, what comprises useful information, and what financial statements should include, are largely consistent between the two frameworks. The same is true of jurisdictional-level financial reporting frameworks that have been developed in a manner consistent with the conceptual basis of IFRS Standards and IPSAS. The similarities will support conceptual coherence.
- 5.13** On guidance timing differences, the international frameworks and jurisdictional-level standards are all subject to different standard setting due processes which move at different speeds and deliver outputs on the same and similar topics at varying points in time. This means that even where there is agreement that standards need revision, some frameworks and jurisdictional-level standards will not be updated at the same time as others. In the proposed model, the presumption will be that the requirements of the *IFRS for SMEs* Standard will be followed to provide a stable foundation. Where another framework has been used to provide a sector specific solution then any updates to the underlying standard could be used for that specific aspect of the Guidance as part of the periodic review of the Guidance aligned to updates of the IFRS for SMEs standard.

How will the Guidance benefit different types of NPO

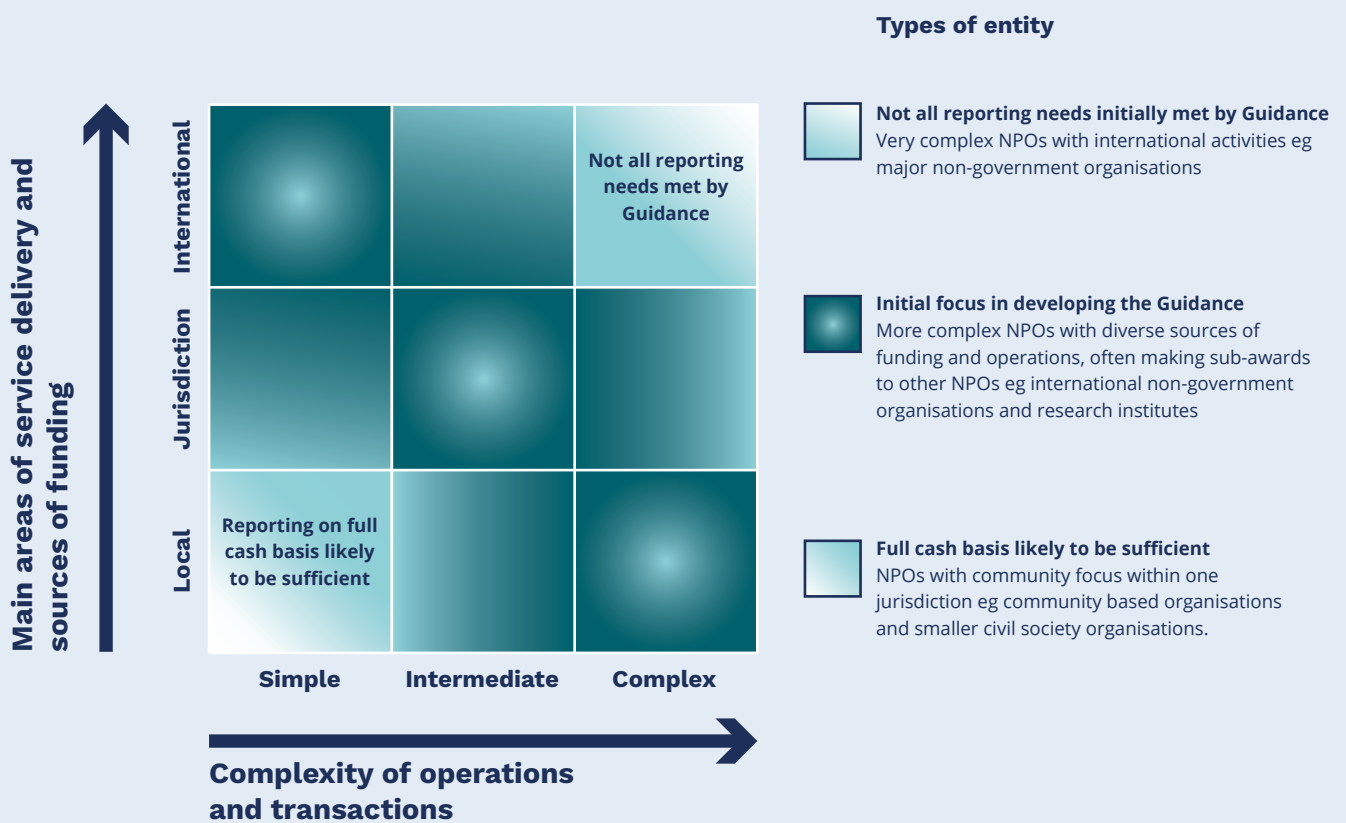
- 5.14** While at a broad level the accountability and decision-making needs of NPOs stakeholders are similar, NPOs do differ in type, activity, geographical coverage, size and complexity. The financial management issues facing them will vary, and as such they and the users of their financial information will not all share the same reporting needs.

¹⁸ A comparison on the conceptual frameworks is contained in Supplementary Information: International and national financial reporting standards and guidance

- 5.15** For example, the reporting needs of NPOs with relatively simple operations and transactions to be reported to users of financial information are likely to be more basic. NPOs with more complex operations and transactions that they need to account for and report on to users are, on the other hand, likely to have reporting needs that are more difficult to satisfy.
- 5.16** As outlined in Chapter 2, NPOs can face significant burdens in complying with different funder and jurisdictional-determined reporting requirements. As such service delivery and funding characteristics can bring additional complexity to financial management for certain types of NPO. This includes those receiving large donations and grants from a number of funders at a jurisdictional and international level and NPOs delivering services across an entire jurisdiction and/or in more than one jurisdiction.
- 5.17** The Guidance is intended for use by all NPOs irrespective of type or size. Those NPOs with complex operations and transactions and/or that have jurisdictional or international level service delivery and funding characteristics could, however, benefit most from the Guidance through the increasing quality, consistency, transparency, comparability and reliability of financial reporting. It is therefore proposed to focus the development of the Guidance initially on the needs of those NPOs that have complex operations and transactions and/or with reporting burdens driven by their funding and service delivery characteristics.
- 5.18** In this initial stage the Guidance is not likely to meet all of the reporting needs of the largest international NPOs. These NPOs can have complex financial reporting requirements that are similar to some of the largest private sector organisations and national governments. While the Guidance will be of use to these entities, it is not initially expected to provide full NPO-specific financial reporting guidance relevant to all of the reporting issues they face.
- 5.19** It is recognised that very small and less complex NPOs, who tend to have local funding sources and deliver services locally, comprise a significant part of the NPO community in many jurisdictions.¹⁹ These NPOs generally focus on ensuring that effective receipts and payments based financial management and reporting processes are in place. Although this approach is likely to be adequate, movement towards financial reporting based on internationally applicable Guidance developed under this project may benefit them over time. This will particularly be the case if they grow and look to attract new sources of funding and/or operate across an entire jurisdiction or in more than one jurisdiction.

¹⁹ Differences in definitions used by jurisdictions make direct comparison difficult but around 60% of NPOs in New Zealand report using the most basic cash accounting tier that is reserved for entities with less than \$NZ 125,000 of operating expenses and approximately 40% of UK charitable organisations have less than £10,000 per annum in income.

Figure 5.3: NPOs that are intended to be the initial focus of the Guidance



Conclusion to Chapter 5: Proposed way forward

- 5.20** Significant improvements can be made to NPO financial reporting by drawing on existing financial reporting frameworks from around the globe. In this chapter, the proposed model provides a credible option for developing the Guidance that will meet the objectives of:
- improving the quality, transparency and credibility of NPO financial reports
 - supporting the provision of NPO financial and non-financial information that is useful for decision making and accountability whilst balancing the needs of preparers and users
 - addressing specific NPO issues, which will promote the comparability of NPO financial reports.
- 5.21** The proposed model will deliver Guidance that provides a full suite of financial reporting standards for NPOs. It will utilise the *IFRS for SMEs* Standard as its foundational framework, and draw on full IFRS Standards, IPSAS, and their broader conceptual frameworks where the *IFRS for SMEs* Standard is silent on NPO-specific reporting issues or does not otherwise provide appropriate and/or sufficient guidance, in order to develop NPO-specific reporting solutions. The model will also draw on jurisdictional-level standards to address gaps in coverage of certain topics, particularly where they have been developed in a manner that is deemed sufficiently consistent with the conceptual basis of IFRS Standards and/or IPSAS.
- 5.22** This proposed model, which can be delivered within the five-year project timeframe, performs better overall against the three criteria used to assess the international frameworks than any one of the three individual frameworks.
- 5.23** Development of the Guidance is proposed to focus initially on those NPOs that have more complex operations and transactions that they need to account for and/or reporting requirements to funders and jurisdictions where current arrangements do not provide adequate solutions.



General Matters for Comment 5

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

- 5.a** 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?



PART 2: NPO- specific financial reporting issues

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**INTERNATIONAL FINANCIAL REPORTING
FOR NON PROFIT ORGANISATIONS**

Overview

Overview

1. Relationship with Part 1 of the Consultation Paper

1.1 Part 1 of this Consultation Paper discusses the broader NPO financial reporting landscape and considers this in the context of the project objectives set out in the Introduction. Part 1 includes a description of the broad characteristics of NPOs. It considers accountability and decision making and the role that general purpose financial reports can play in providing decision useful information for external stakeholders. Finally, it looks at the suitability of existing international and national financial reporting regimes as the basis of future NPO Guidance.

1.2 Part 2 of this Consultation Paper considers a number of NPO-specific financial reporting issues. It raises questions that are relevant to the project objectives, such as balancing the needs of preparers and users and improving the transparency of NPO financial reports. However, the main focus is to assist in delivering the third project objective:

Objective 3: To address specific NPO issues, which will promote the comparability of NPO financial reports.

1.3 Part 2 is written for those interested in the technical accounting considerations of NPO-specific issues. The language is necessarily more technical in nature than in Part 1, with the main terms explained in the Consultation Paper Glossary. These terms are not intended to be used as definitions, with many having specific meanings in different jurisdictions and in national and international accounting and other professional frameworks. Definitions will be developed as part of the Exposure Draft.

1.4 This part of the Consultation Paper sets out how the list of NPO-specific financial reporting issues for potential consideration was originally identified and provides a description of the nature of each issue. The criteria used for selecting the issues to be included in the Consultation Paper, and therefore probably in the initial Guidance, are also included.

1.5 Analysis is provided for each of the NPO-specific financial reporting issues currently proposed for the initial Guidance. Alternative approaches that could be pursued to address each issue are included to generate feedback. These alternatives are consistent with the proposed Guidance model in Part 1: Chapter 5.

2. Identification and Selection of NPO-specific financial reporting issues

- 2.1 Reporting issues for NPOs have been subject to much debate globally for many years. They have been reported:
- in academic studies
 - by standard setters
 - by stakeholders and members of the NPO community, including donors.
- 2.2 The project team has compiled a list of NPO-specific issues from these sources. The types of issues identified may be grouped under the five broad categories in Figure 2.1:

Figure 2.1: NPO financial reporting issue categories²⁰



²⁰ Issues have come from the CCAB report (2014), the ACCA Companion Guide (2015), the IFASS Working Group and from Advisory Group members. For further information see Supplementary Information: Additional project information.

- 2.3** Non-exchange transactions, which include donations, grants and volunteer services, feature heavily in the list. These transactions are characterised by situations where the provider of the resources does not themselves directly receive goods and/or services of approximately equal value in return for the resource they provided.
- 2.4** The description of each issue has been developed, with input from the project advisory groups,²¹ to contextualise the nature of each issue. The list is intended to only include issues that are specific to NPOs. It is not intended to cover financial reporting issues of a more general nature that are also relevant to the public sector and private sectors. It is important that the list of issues is complete to create a framework for the work to be carried out over this and subsequent phases of the project.
- 2.5** In this initial phase of the project, it will not be possible for every NPO-specific issue to be addressed because of time and resource constraints. Prioritisation will therefore be necessary to focus efforts on the issues that will have the most significant impact, helping to deliver the project objectives and in doing so, the potential to add greatest value to NPOs.
- 2.6** Four criteria have been developed for evaluating the relative priority of each issue as set out in Figure 2.2. These criteria have been used to assess the issues in Table 2.1 Priority issues and in Table 2.2 Issues to be considered in later phases.
- 2.7** To summarise, the topics proposed for inclusion in the Guidance will be those NPO-specific issues that have been evaluated to have potential to provide the best outcome **across all four criteria**. This might mean that an issue is not included if it only features highly against one of the criteria. For example, feasibility on its own may not be sufficient for an issue to be prioritised.
- 2.8** Table 2.1 shows the list of the NPO-specific financial reporting issues that were prioritised for inclusion in the Consultation Paper after evaluation using these criteria. Table 2.2 provides a list of topics that could be considered in the future. Further background on these topics is provided in Annex A.

²¹ For further information about the project advisory groups see Supplementary Information: Additional project information.

Figure 2.2: Criteria for NPO-specific issue prioritisation

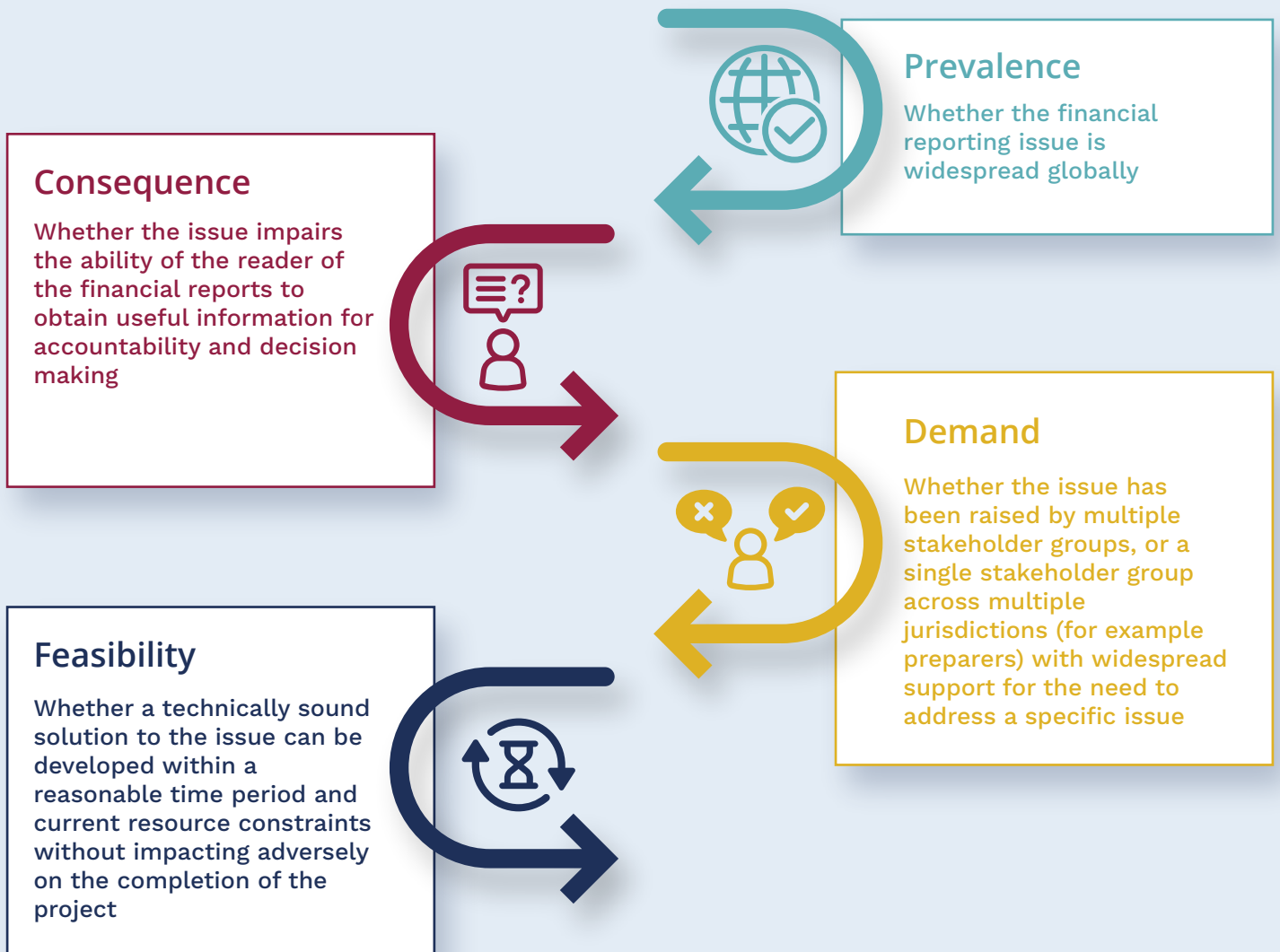


Table 2.1: NPO-specific financial reporting issues prioritised for the Consultation Paper

| No | Topic | Page |
|---|--|------|
| Reporting entity | | |
| 1 | Reporting entity and control (including branches) | 77 |
| 2 | Acting on behalf of another entity | 87 |
| Accounting for incoming resources | | |
| 3 | Revenue: Recognition and measurement of incoming resources from external sources, including cash contributions, gifts in-kind and services in-kind | 98 |
| Accounting for outgoing resources | | |
| 4 | Grant expenses | 117 |
| Accounting for non-financial assets | | |
| 5 | Measurement of tangible and intangible assets held for social benefit | 126 |
| 6 | Inventory held for use or distribution | 138 |
| Presentation, content and scope of Financial Reports | | |
| 7 | Financial statement presentation | 151 |
| 8 | Classification of expenses – function or nature | 161 |
| 9 | Fundraising costs | 170 |
| 10 | Non-financial reporting (including service reporting) | 178 |

Table 2.2: NPO-specific financial reporting issues to be considered in later project phases

| No | Topic |
|---|---|
| Reporting Entity | |
| 11 | Mergers and acquisitions (combinations) |
| 12 | Intragroup transactions |
| Accounting for incoming resources | |
| 13 | Recognition of legacy/bequest income and endowments |
| Accounting for non-financial assets | |
| 14 | Heritage assets and/or obligations |
| 15 | Concessionary loans for social purposes |
| 16 | Concessionary leases |
| 17 | Accounting for investment/financial assets |
| 18 | Service concessions arising in NPOs as grantor |
| 19 | Service concessions arising in NPOs as operator |
| Presentation, content and scope of financial reports | |
| 20 | Related party transactions |
| 21 | Remuneration/pay disclosures |
| 22 | Foreign currency transactions |



Specific Matters for Comment 0

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

- 2.9** Additions to the list of issues will only be made for issues that are NPO-specific. Issues added to the list will be evaluated against the criteria to determine whether they should be considered in the initial phase of the project, or in a subsequent phase. Re-prioritisation of issues to be included in the initial phase may be required to ensure that it is feasible to deliver the Guidance within the project timeline.

3. Issue papers

- 3.1** Sections 1-5 of this part of the Consultation Paper contain a discussion of a series of issues that provide a more in-depth look at the NPO-specific financial reporting topics prioritised for consideration as listed in Table 2.1. They seek to engage with potential users on each issue, particularly to confirm the understanding of the issue and obtain feedback on alternative ways forward. This feedback is critical ahead of detailed technical development, which will take place in the next stage of the project ie, developing the Exposure Draft.
- 3.2** The papers do not include regulatory issues such as impacts on tax or impacts on audit thresholds that might arise from the alternatives, which are likely to be jurisdiction specific. These are areas on which feedback is encouraged through the specific matters for comment identified for each issue.
- 3.3** The issue papers provide information about existing international financial reporting guidance, and also give examples of how issues have been addressed in some national guidance. These guidance sources have provided the building blocks for the alternative approaches that have been developed for each of the issues.
- 3.4** Not all topics have the same number of alternatives, and the alternatives considered are topic specific. All issue papers include at least one alternative that is a tailored solution consistent with the Guidance model proposed in Part 1: Chapter 5.

- 3.5** Examples of the accounting treatments that might result from each of the alternatives are not provided in this Consultation Paper given the early stage of development. There is, however, a description of potential advantages and disadvantages to indicate the expected impacts. No weighting has been given to these potential impacts, but the likelihood is that some will be more significant to respondents than others. To standardise the presentation of the advantages and disadvantages, the analysis considers:
- **Technical points** – for example, level of consistency likely with international standards, whether an alternative might improve a technical aspect or creates a new technical issue.
 - **Practical points** – the extent to which the alternative might make it easier or more difficult for NPOs to prepare their financial reports.
 - **Stakeholder perspectives** – the potential benefits for users of the accounts, or potential barriers for preparers, usually expressed with reference to understandability, comparability and transparency.
 - **Cost/benefit considerations** – the potential impact on costs and where appropriate how these relate to potential benefits.
- 3.6** The issues papers do not include a preference for any alternative. However, a few alternatives may have less technical merit. Such alternatives have been included because of the perceived pragmatic benefits of a proposal.
- 3.7** Each issue paper follows the same format as set out in Figure 3.1.

Figure 3.1 Issue paper structure



- 3.8** Each issue paper is supported by supplementary information gathered from a number of jurisdictions, predominantly those that have specific guidance for the non-profit sector. This illustrates various treatments adopted around the world and provides details of the location of the national guidance where this is in the public domain. This information can be found in the Supplementary Information section: International and national financial reporting standards and guidance for NPOs.

4. Responding to the Consultation Paper

- 4.1** Each issue paper has Specific Matters for Comment (SMCs), which are in addition to the questions contained in this overview. Each issue paper invites responses to a standard set of SMCs and may, by exception, include additional questions. These standard questions focus on the description of the issue and the alternatives.
- 4.2** Respondents are invited to express a preference from the alternatives provided or put forward further alternatives with the rationale for the response provided. Alternatives that gain the greatest support through this consultation paper will be prioritised for further development as part of the Exposure Draft.
- 4.3** Responses may be made to any of the matters raised and there is no need to respond to them all. However, the evidence base to support the development of the Exposure Draft will be improved if more comments are received. Respondents are therefore encouraged to respond to as many SMCs as relevant.
- 4.4** Additional matters can be raised in responses, where these are not covered by the SMCs. Section 6 of the Introduction provides further information about how to respond to this Consultation Paper.

Annex A

Background on issues that are not included in Sections 1-5²²

| Topic | Issues |
|---|---|
| Reporting entity | |
| Mergers and acquisitions (combinations) | What is the accounting treatment for the combination of two or more NPOs? Should merger accounting be permitted/required? If the acquisition method is required what is the accounting for a gain/negative goodwill? |
| Intragroup transactions | When is income from a subsidiary recognised in the parent NPO's accounts, taking account of legal considerations relating to the way in which the profits of a subsidiary are given to a parent? What disclosure should be required by both sides of the relationship/transaction when a branch is part of a larger NPO or an NPO is part of a group? |
| Accounting for incoming resources | |
| Recognition of legacy/bequest income and endowments | When should bequests be recognised? What are the considerations involved with perpetual trusts and/or a portfolio of similar smaller assets? How are endowments recognised and classified, including the treatment of the initial contribution, subsequent changes in the value of the initial contribution and treatment of income earned? How should income from endowments be presented in the Statement of Financial Performance and Statement of Financial Position (balance sheet)? What disclosures should be required for any restrictions on the entity? |
| Accounting for financial and non-financial assets | |
| Heritage assets and/or obligations | Recognition and measurement of heritage assets. What disclosures should be made about the nature and scale of heritage assets and acquisition, preservation etc. of the collection? Recognition and measurement of significant heritage obligations, and any impact on the measurement of related assets. |
| Concessionary loans for social purposes | What is the definition of a concessionary loan? What is the initial and subsequent measurement of special credit conditions? What is the treatment within a group if there is an inter-company loan with a for-profit entity? What disclosures should be made? |
| Concessionary leases | How should such arrangements be accounted for? |
| Accounting for investment/financial assets | Classification, recognition and measurement requirements. |
| Service concessions arising in NPOs as grantor | When do these arise in the non-profit sector eg low income housing? What disclosures are required? |
| Service concessions arising in NPOs as operator | When do these arise in the non-profit sector eg low income housing? What disclosures are required? |
| Presentation, scope and content of financial reports | |
| Related party transactions | Definition and required disclosures of related party transactions. Implications of local legal requirements? |
| Remuneration/pay disclosures | What disclosures should be made and who should be included? The relationship with related party disclosures? |
| Foreign currency transactions | Whilst there are no sector specific issues with accounting for foreign currency transactions, how should requirements by donors that a particular exchange rate is used for specific transactions be addressed in financial reporting? Where should foreign exchange gains and losses be presented on the Financial Reporting Statement? How is consistency of reporting achieved? |

²² Issues were not included based on the discussions in paragraphs 2.5-2.8.



Section 1: Reporting entity

| | |
|---|----|
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| Issue 2: NPOs acting on behalf of other entities | 87 |

Section 1: Reporting entity

NPOs can be organised in a variety of different ways, using internal structures focused on specific activities, through subsidiaries, partnerships or other types of arrangements. As a consequence, issues have been raised about what is a reporting entity and how to account for entities that are part of a group. These focus on what defines a reporting entity and when does one entity control another. Given the focus on control this section also considers how to account for transactions that an NPO is carrying out on behalf of another entity. Other NPO-specific consolidation issues are not proposed to be included in the initial Guidance.

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?

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 its accountabilities.

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)?

Issue 1: Reporting entity and control (including branches)

1. Description of the issue

- 1.1 Transparency improves comparability between similar types of NPOs that have different operating structures.** Full transparency and accountability over the assets and liabilities of NPOs is critical to financial reporting. Users need to know which activities are part of the reporting entity and the critical relationships with other entities.
- 1.2 NPOs may have complex organisation structures to deliver their objectives.** NPOs often operate across multiple geographical areas. NPOs can supply a similar service to different areas of the same jurisdiction, or on an international basis, supply services to other jurisdictions. Activities that take place across a range of locations may be organised through a series of separate offices. Alternatively, assets, staff and/or resources may be formally allocated to a specific activity within an entity.
- 1.3 Activities may not be delivered through a common model.** Activities may be delivered through separate legal entities or in partnership with another entity. Also, service recipients or supporters of an NPO may form entities to partner with and/or support an NPO.
- 1.4 Many NPOs operate through a system of 'branches',** with a branch being an internal structure created to carry out activities. Branches are part of an NPO's operating structure and may be established to provide specific arrangements in a locality. They may also be used for fundraising. Branches may have their own bank accounts, with funds raised for specific local projects.
- 1.5 NPOs can appear similar to the public but require different financial reporting arrangements.** NPOs may have service arrangements with local offices that are separate reporting areas, within an NPO. These reporting areas could have their own differing financial reporting arrangements. NPOs could also have service arrangements with other entities controlled by an NPO and insist on uniform activities and financial arrangements consistent with an NPO's central requirements. A range of examples include a local organisation affiliating with an NPO's national brand to benefit from logos, insurance etc, but maintaining its own financial and governance arrangements. Recognising these local organisations as a reporting entity can help internal decision-making in respect of assets and liabilities (ie resources and potential risks).

- 1.6 NPOs can face practical issues in producing their financial statements.** For example, an NPO may experience resistance to controls over local organisations (including branches) provided by legal powers. Branches may resist requests by an NPO and not submit financial returns or provide other information. Enforcement activities may not be worthwhile where individual branches are immaterial to the parent NPO's accounts.
- 1.7 Determining whether an activity or branch is a separate reporting entity is often not easy.** The nature and complexities of the relationships that exist may make it challenging to decide when an activity or branch is part of an NPO, when it is part of a separate standalone reporting entity, or when it is part of a separate reporting entity controlled by an NPO.
- 1.8 Branches might not publicly report anywhere in the world** because they are not included in any financial reports. This might occur where a branch is not included, for example, in the accounts of its international based headquarters organisation and is also not considered a reporting entity in the jurisdiction that it is operating.
- 1.9 Having trustees that are common across NPOs might raise questions about the relationship between NPOs.** This might occur where two NPOs with different operations have common trustees or a significant overlap in trustees. There are also questions where trustees have the ability to appoint trustees or board members in other related entities.

2. Financial reporting challenges

- 2.1 NPOs need to follow the requirements of local regulators.** This may influence the way in which reporting entities are identified and subsequently treated in an NPO's financial reports.
- 2.2 Different regulatory frameworks can exist within national jurisdictions** for different types of NPOs as well as between them. For example, a UK charity registered as a company follows requirements specified by the Companies Act 2006 while a social enterprise charity will follow the Charities Statement of Recommended Practice (SORP). The different frameworks may lead to different financial reporting outcomes for similar activities (although arguably in the UK these regulatory frameworks will lead to similar results for the majority of cases).
- 2.3 NPOs may require substantial information and analysis to make judgements about control.** Determining the degree of control sufficient to recognise the assets and liabilities (and other resources) of a separate activity or reporting entity in the financial statements of an NPO may be challenging because of the nature of the relationships.

- 2.4 There may be severe long-term restrictions that hinder control.** In some situations, the ability of one NPO to exercise rights over another may be limited. Alternatively, an entity may be held exclusively with a view to its subsequent resale. The identification of severe long-term restrictions requires a highly subjective assessment and may fluctuate wildly over relatively short periods of time.
- 2.5 The definition of a reporting entity needs to be consistently applied.** There is a challenge in deriving definition of a reporting entity suitable for NPOs so that users get comparable information. The definition needs to be workable regardless of the way in which an NPO decides to operate. NPOs will need to ensure that decisions relating to control are consistent.
- 2.6 Without additional disclosures it may not be clear what is included** as part of an NPO (ie which, if any, branches are included) and which entities are controlled and form part of an NPO's financial statements. The challenge involves the need to provide transparency, including the judgements being made to foster users' understanding of the reporting entity and the ability to assess comparability with other NPOs.

3. Current international guidance

- 3.1** Currently international guidance on the reporting entity and control relationships between entities is provided in:
- IFRS Foundation Conceptual Framework²³ – Reporting Entity chapter
 - IPSASB's Conceptual Framework²⁴ – Reporting Entity chapter
 - IFRS 10 *Consolidated Financial Statements*
 - Section 9 of the *IFRS for SMEs* Standard
 - IPSAS 35 *Consolidated Financial Statements*.

Reporting entity definition

- 3.2** The International Accounting Standards Board (IASB) and IPSASB conceptual frameworks include very similar definitions of reporting entities. The IASB states that a reporting entity is an entity that is required, or chooses, to prepare financial statements. The IPSASB definition establishes that a reporting entity is a government or other public sector organisation that produces general purpose financial statements. They both confirm that reporting entities need not be legal entities.
- 3.3** Both definitions recognise the role that control can play in the definition of a reporting entity, ie that it can be more than one organisation and that the reporting entity can be parent of a group.

²³ IFRS Foundation Conceptual Framework for Financial Reporting.

²⁴ IPSASB's Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities.

Definition of control

- 3.4** The definition of control in IFRS 10 *Consolidated Financial Statements* focuses on the substance of transactions and not their legal form. The key principle in IFRS 10 is that an investor controls an investee, if and only if, the investor has:
- power over the investee
 - exposure, or rights, to variable returns from its involvement with the investee
 - the ability to use its power over the investee to affect the amount of the investor's returns.
- 3.5** IPSAS 35 is largely aligned with IFRS 10 and uses the same definition of control but includes a number of amendments to reflect public sector circumstances. Those relevant include:
- removal of references to 'investor'
 - use of the term 'benefits' instead of 'returns'
 - modification to highlight the range of relevant activities that could occur in the public sector
 - clarification that regulatory control and economic dependence do not give rise to power for the purposes of the standard(s).
- 3.6** Both IFRS 10 and IPSAS 35 state that to have power over another entity, an entity must have existing rights that give it the current ability to direct the relevant activities. The relevant activities are those activities that significantly affect the nature or amount of the benefits from its involvement with the other entity.
- 3.7** The definition of control in the *IFRS for SMEs* Standard is aligned with the principles-based definition of control from the superseded version of IAS 27 *Consolidated and Separate Financial Statements*. Control is defined as the power to govern the financial and operating policies of an entity to obtain benefits from its activities. The *IFRS for SMEs* Standard uses a different (and narrower) definition of control which is supported by provisions that are more pragmatic.
- 3.8** Under the *IFRS for SMEs* Standard control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity. The standard states that this presumption may be overcome in exceptional circumstances if it can be clearly demonstrated that such ownership does not constitute control.

4. National-level guidance²⁵

- 4.1** In national level guidance gathered there are essentially two approaches being taken that reflect the international standards available. Some jurisdictions

²⁵ Additional information on national guidance of a limited number of jurisdictions can be found in Supplementary Information: International and national financial reporting standards and guidance.

follow the international standards for the private and public sectors and require NPOs to determine control based on principles that relate to the substance of the relationship between entities, supported by additional guidance specific to NPOs.

- 4.2** In other jurisdictions there is a closer relationship to the *IFRS for SMEs* Standard. In these jurisdictions, although there is a principles-based definition of control, it is narrower, and the focus of the supporting provisions is on the voting or operational control of the entity. Guidance is also provided about the sets of circumstances that would suggest control.
- 4.3** In addition, some jurisdictions have provided additional guidance about branches. In one jurisdiction there is specific guidance about branches which it notes include special trusts, linked or connected charities and certain joint ventures of charities but that do not involve a separate joint venture. Branches are deemed to be the legal property of a charity and reflect a charity's administrative arrangements whereby its internal operating structure is arranged according to function, location or other factor designed to facilitate its administration.
- 4.4** Another jurisdiction provides indicators that an organisation may be a branch and/or whether a branch is a separate reporting entity. The indicators that an organisation may be a branch can relate to the branding of the organisation (naming, registrations, websites) and financial support.

5. Alternative financial reporting treatments

- 5.1** NPOs can have unique types of arrangements both within and between different types of entities. There is some national level guidance specific to such arrangements, but no international guidance. Both alternative approaches proposed are built on the basis that NPO-specific guidance is developed to address these types of arrangement, including 'branches' which are common within the sector. The addition of NPO-specific guidance as part of both alternatives will provide the potential to improve the transparency over the scope of an NPO's activities.
- 5.2** **Alternative 1** is based on the preparation of this additional NPO-specific guidance, using a principles-based approach to determine whether one entity has control over another. This alternative uses the substance over form principles included in IFRS Standards and IPSAS (IFRS 10 and IPSAS 35).
- 5.3** The control models under IFRS Standards and IPSAS both include substantial reporting requirements (a separate standard) to present an entity's interests in other entities. Additional guidance is proposed to explain how the principles should be applied and appropriate disclosures. Disclosures would be focused

to provide appropriate information to understand the structure, risks and impacts of any branches operating within an NPO and related to other entities.

- 5.4 Alternative 2** proposes the use of pragmatic methods of assessment such as the power to govern financial and operating policies to define control as required by the *IFRS for SMEs* Standard²⁶. This alternative would focus on key characteristics that define NPO relationships and use the control principles set out in IFRS 10 and IPSAS 35 to develop tests to determine control. This may be a more pragmatic approach, particularly for smaller NPOs than a potentially more resource intensive assessment using principles.
- 5.5** The alternatives proposed do not address consolidation issues or where a branch might be an associate or joint venture and only goes to what is a reporting entity and where they sit from a control perspective in a reporting structure. Consolidation will be addressed as a separate topic and is not proposed for inclusion in this first phase of the IFR4NPOs project.

²⁶ The International Accounting Standards Board has initiated a programme to review the *IFRS for SMEs* Standard and in particular to consider updates for standards issued since the last update. This will include IFRS 10 *Consolidated Financial Statements*.

| | Description | Advantages | Disadvantages |
|---|--|--|--|
| <p>Alternative 1</p> <p>Prepare additional NPO-specific guidance on the nature of reporting entities and use the principles-based approach of substance over form to define control.</p> | <ul style="list-style-type: none"> Prepare additional NPO-specific guidance about how to identify a reporting entity including branches. To determine control, use the three principles: <ul style="list-style-type: none"> power over the entity exposure, or rights, to variable returns/benefits from its involvement with the other entity the ability to use its power over the other entity to vary the returns/benefits. Provide additional guidance on how to apply the principles for NPOs including how to specify relevant activities, ie those activities that significantly affect returns on a public benefits basis. Provide guidance on disclosures to focus on structure, risks and impacts of branches and other related entities. | <p>Technical</p> <ul style="list-style-type: none"> Allowed by both IPSAS and IFRS and broadly consistent with the <i>IFRS for SMEs</i> Standard. The specifications of benefits and relevant activities can be used to determine control for NPOs. <p>Practical</p> <ul style="list-style-type: none"> Principles provides flexibility to allow for variations in local environments. Provides guidance on NPO-specific relationships and arrangements. | <p>Technical</p> <ul style="list-style-type: none"> Additional guidance may have the effect of turning a principles-based approach into a rules-based approach. <p>Stakeholder</p> <ul style="list-style-type: none"> May impact comparability with other NPOs and entities in the public benefit and public sectors if there are different interpretations of the principles. <p>Cost/benefit</p> <ul style="list-style-type: none"> The cost of determining whether control exists may outweigh the benefits, particularly for smaller entities. |
| <p>Alternative 2</p> <p>Prepare additional NPO-specific guidance on the nature of reporting entities and use pragmatic methods of assessment such as the power to govern financial and operating policies to define control.</p> | <ul style="list-style-type: none"> Prepare additional NPO-specific guidance about how to identify a reporting entity including branches. Establish supporting guidance based on a pragmatic approach to identify control. For example, the power to govern the financial and operating policies of an entity to obtain benefits from its activities, ie where through direct or indirect ownership more than half of the voting power is held). Guidelines would be based on 'bright lines' tests eg voting rights. Substantive judgments, ie control of financial and operating policies and/or materiality would be required based on the guidance. Provide guidance on disclosures to focus on structure, risks and impacts of branches and other related entities. | <p>Technical</p> <ul style="list-style-type: none"> Is currently consistent with the <i>IFRS for SMEs</i> Standard. <p>Practical</p> <ul style="list-style-type: none"> May be easier to apply. Provides guidance on NPO-specific relationships and arrangements. <p>Stakeholder</p> <ul style="list-style-type: none"> May be easier for users to understand. May improve comparability across NPOs. <p>Cost/benefit</p> <ul style="list-style-type: none"> May be less resource intensive. | <p>Technical</p> <ul style="list-style-type: none"> Is not consistent with the principles-based approach in IFRS or IPSAS. A pragmatic approach risks being unable to properly reflect the economic circumstances of an NPO's interests. <p>Practical</p> <p>Might be difficult to arrive at a single set of pragmatic methods that meet the needs of the broad range of NPOs in the sector.</p> |



Specific Matters for Comment 1

- 1.a** Do you agree with the description of issue 1: Reporting entity and control (including branches)? If not, why not?
- 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.
- 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.
- 1.d** Please identify the alternative treatment that you favour for issue 1, and the reasons for your view.

Issue 2: NPOs acting on behalf of other entities

1. Description of the issue

- 1.1 Distinguishing between where an NPO acts as an agent for other entities or is acting in its own right is important.** This is to understand the accountability of an NPO, to provide transparency over its operating income and expenditure and to understand an NPO's operating model. However, it can be challenging to identify where an NPO is the principal, responsible for its own decisions.
- 1.2 It may be difficult for an NPO to decide who is responsible for making the decisions** about the assets it has in its care. An NPO can act as an 'accountable body' for a grant even where an NPO distributes that grant to other NPOs or organisations. An NPO may be entitled to some of the grant itself, or may be responsible for the administration of the monies. The funder may deem an NPO distributing the funds to be accountable.
- 1.3 NPOs might be responsible for distributing donor funds or grants.** NPOs can act as a custodian or a trustee of funds or assets for other entities. For example, an NPO may agree to pass on funds to other NPOs or agencies. This could be because it has particular expertise or knowledge in a local area where the principal entity does not. In these situations, an NPO will not have the ability to decide how such resources are allocated but may retain some accountability and have reporting requirements.
- 1.4 It may be difficult to identify who is acting as principal if there are no formal agreements** setting out the arrangements between the parties. This is particularly where multiple tiers of entities, partnerships or consortia exist. For example, issues may arise in joint consortia, where an NPO may act as principal in one part of the consortium's activities, and agent in another because it is administering an activity.
- 1.5 Use of sub-contractors to provide services or distribute funds might also make it difficult** to identify whether there is an agency relationship. An NPO might still be an agent if it only has the responsibility for distribution of the funds.

2. Financial reporting challenges

Recognition

- 2.1 NPOs need to understand whether they have the rights to control cash or other asset they are holding,** be that its economic benefits or inherent service potential. If an NPO is acting as an agent, then the funds or assets

being held are not recognised by an NPO (and could be held in some form of holding account).

- 2.2 Expenditure should not be netted off from any of the contributions received, when presented as income and expenditure, or within assets or liabilities**, where an NPO is acting as principal. Funds granted or donated should be presented gross.

Disclosure

- 2.3 Disclosure may be required of the amounts passing through an NPO or assets in custody to provide transparency.** Donors and grant providers are likely to be interested in the security and fiduciary responsibilities that an NPO might have for funds passing through an NPO or the assets it is holding in custody. How these funds could be reported in the agent's financial statements are important. A gross reporting approach, similar to when an NPO is acting as principal could provide additional transparency.
- 2.4 It is arguable that financial reporting should cover the full details of programmes that include both elements of agent and principal.** There is a need for clarity and transparency. There may be a need for users (eg donors and other funders) to fully understand the financial performance and the risks faced by NPOs where they are part of a consortium.

3. Current international guidance

- 3.1** Currently international guidance focusing on agency arrangements is included in the following standards:
- IFRS 10 *Consolidated Financial Statements*
 - IFRS 15 *Revenue from Contracts with Customers*
 - Section 23 of the *IFRS for SMEs Standard*²⁷
 - IPSAS 9 *Revenue from Exchange Transactions*²⁸
 - IPSAS 23 *Revenue from Non-exchange Transactions (Taxes and Transfers)*
 - IPSAS 35 *Consolidated Financial Statements*.
- 3.2** Generally, the guidance provided by the standards is based on the core principle that an entity is principal if it 'controls' the economic resource in the transaction(s). Current international guidance has either a controls approach or risks and rewards approach to indicate control.

²⁷ The International Accounting Standards Board has initiated a programme to review the *IFRS for SMEs Standard* and in particular to consider updates for standards issued since the last update. This will include IFRS 15 *Revenue from Contracts with Customers*.

²⁸ The International Public Sector Accounting Standards Board will shortly consult on a new standard to replace IPSAS 9 *Revenue from Exchange Transactions* to reflect IFRS 15, as well as a linked update of IPSAS 23.

- 3.3** While the framework for assessing control differs, the guidance provides indicators to assist entities with the determination of whether an entity would be acting as principal, focusing on an entity's ability to control (or whether it is subject to risks and rewards of the good or service provided). These indicators include consideration of which entity has primary responsibility for the provision of the good or service to the customer, inventory risk, credit risk exposure and the ability to set prices for the good or service provided.
- 3.4** International standards both within their conceptual frameworks and in specific standards (for example, property, plant and equipment and the leasing standards), follow the principle that holding legal title to an asset is not sufficient to require its recognition in an entity's balance sheet. Again, what must be established is that an entity controls or has the right to control the economic benefits and service potential inherent in the asset.

Controls approach

- 3.5** IFRS 15, where revenue is provided in exchange for a good or service, is based on a control concept. IFRS 15 does not provide guidance on non-exchange transactions.
- 3.6** IFRS 10 requires entities to decide whether an investor is acting as principal or agent and/or whether it controls the entity it has an interest in. Guidance establishes that an investor engaged primarily to act on behalf of other parties does not control the investee and is an agent.
- 3.7** Similar to IFRS10, IPSAS 35 requires entities to decide whether an investor is acting as principal or agent and/or whether it controls the entity it has an interest in and provides guidance.

Risks and rewards approach²⁹

- 3.8** The accounting treatment in the *IFRS for SMEs* Standard for agency relationships although not explicitly referring to 'risks and rewards' is included in Section 23 *Revenue* where decisions on the supply of goods are taken on the basis of a 'risk and rewards' approach. The *IFRS for SMEs* Standard specifies that in an agency relationship, the agent must recognise in revenue only the amount of its commission.
- 3.9** IPSAS 9 sets out that an entity is acting as an agent when it does not have exposure to the significant risks and rewards associated with the sale of goods or the provision of services.

²⁹ Although there is a difference in the principles established for the determination of whether an entity is acting as agent or principal (ie the control or risk and reward framework), it is arguable that any outcomes are likely to be similar as risks and rewards are a subset of control though different decisions are possible.

- 3.10** Both IPSAS 9 and IPSAS 23 establish that amounts collected as an agent of the government (or another government organisation/other third party) will not give rise to an increase in net assets or revenue of the agent. This is because the agent cannot control the collected assets in the pursuit of its objectives. It establishes the same principle for fines. These principles are capable of being applied to other non-exchange transactions such as the distribution of grants.
- 3.11** Both IPSAS 9 and IPSAS 23 as well as the *IFRS for SMEs* Standard are in the process of being updated. The principles in IFRS 15 are specifically included within the considerations for both these work programmes.

4. National-level guidance³⁰

- 4.1** Where a jurisdiction follows either IFRS Standards or IPSAS standards the principles established in section three largely apply.
- 4.2** One jurisdiction, following the general approach under international standards for accounting for transactions as principal or agent, provides specific guidance for charities, ie accounting for custodian funds as agents or trustee (custodian trustee). It establishes the principles for when a charity would treat such transactions as agent or principal. For example, as agent, the trustees of a charity are not able to take decisions about the use to which the funds received are put. It also provides for situations where a charity holds the title of a property on behalf of another charity.
- 4.3** This jurisdiction stipulates that for transactions where a charity is acting as agent (eg receipt of funds) they are not recognised in a charity's accounts, because they are not the income of the charity. Fees receivable are recognised. It also provides the accounting requirements for consortia indicating that the:

“Lead charity is not acting as agent if it is the principal under the contract and is then subcontracting work to third parties.”

There are also requirements to disclose an analysis of funds and assets held as agent and as custodian trustees.

- 4.4** The guidance provided in another jurisdiction is similar but includes detailed provisions on the treatment of transactions including the treatment of financial intermediaries. Whether a recipient NPO that is an intermediary is either principal or agent is dependent on whether an NPO has discretion in the distribution of the money to the beneficiaries. If discretion exists, or if an NPO is a financially related entity, an NPO is the principal in the transaction. If it has

³⁰ Additional information on national guidance of a limited number of jurisdictions can be found in Supplementary Information: International and national financial reporting standards and guidance.

no discretion, it recognises an asset and a liability (for amounts which have not yet been distributed).

- 4.5 In this jurisdiction if the asset is a non-financial asset an NPO is able to choose an accounting policy to not recognise this transaction. This accounting policy choice would need to be disclosed and must be consistent between reporting periods. Under this national GAAP there is no requirement to present the gross amount received.
- 4.6 Another jurisdiction provides guidance on when amounts should be reported gross in the financial statements. It also states that revenue should only include gross inflows of economic benefits received on its own account. It uses the risks and rewards approach to determine when an NPO is principal or agent.

5. Alternative financial reporting treatments

- 5.1 Internationally, national standards require transactions to be recognised in the financial statements based on whether the entity controls the transaction, but there are differences in how control is assessed.
- 5.2 All alternatives propose to include additional NPO-specific examples and guidance that illustrate typical NPO arrangements. They also propose additional disclosure requirements that provide, for example, transparency of material transactions and balances for assets held on behalf of others. Additional disclosures will be advantageous to stakeholders.
- 5.3 Additional disclosure requirements could increase the reporting burden (and potentially audit fees), particularly for smaller NPOs. However, practical guidance for NPO account preparers will assist NPOs in making relevant judgements and reduce the inconsistent treatment of transactions through differing interpretations of the core standards.
- 5.4 **Alternative 1** is based on IFRS Standards and uses the indicators of control identified in Section 3 for IFRS 10.
- 5.5 **Alternative 2** is based on the *IFRS for SMEs* Standard which effectively adopts a risks and rewards approach. The *IFRS for SMEs* Standard is being reviewed to consider newly issued IFRS Standards, which includes IFRS 10. A risks and rewards approach is likely to give a similar outcome to that in alternative 1.
- 5.6 **Alternative 3** is based on IPSAS which currently supports a risks and rewards approach. The existing standard is in the process of being updated and current proposals are for a controls basis consistent with IFRS 10. Once updated, IPSAS is likely to deliver the same outcome as alternative 1.

- 5.7** Given the current work programmes of IPSASB and the IFRS Foundation, it is possible that full IFRS Standards, the *IFRS for SMEs* Standard and IPSAS will all follow the same approach to control within the lifetime of this project. In practice it is possible that all approaches may therefore harmonise on alternative 1.

| | Description | Advantages | Disadvantages |
|---|---|--|---|
| <p>Alternative 1</p> <p>Follow IFRS Standards – based on control with additional guidance and non – profit examples and with additional disclosure requirements.</p> | <ul style="list-style-type: none"> • NPOs would determine whether they were acting as principal or agent based on whether they control the resources involved in a relevant transaction. • No transactions (other than cash flows) would be recognised in the financial statements where an NPO determines that it is acting as an agent in a relationship or for a set of transactions. • Additional guidance on how control is determined and how to measure the asset held with specific examples to illustrate NPO arrangements. • Additional disclosures of material agency relationships NPO, including: <ul style="list-style-type: none"> • a description of the entities or individuals involved in the relationship • a reconciliation from opening to closing balances of material agency transactions, • any major variances. | <p>Technical</p> <ul style="list-style-type: none"> • Other standards may be moving to IFRS Standards definitions, so this alternative may be more technically enduring. | <p>Practical</p> <ul style="list-style-type: none"> • It might be difficult to provide examples that work and illustrate the relationships for all forms of NPOs. • It may be demanding, particularly for smaller NPOs to collate the information necessary to make the judgements about the indicators of control. <p>Cost/benefit</p> <ul style="list-style-type: none"> • May result in additional costs to make assessments which outweigh the benefit |
| <p>Alternative 2</p> <p>Follow the <i>IFRS for SMEs</i> Standard where decisions on agent and principal are made on an exposure to risks and rewards. Additional guidance and not for profit examples and with additional disclosure requirements.</p> | <ul style="list-style-type: none"> • NPOs would determine whether they were acting as principal or agent based on whether an NPO was exposed to significant risks or rewards in a transaction or relationship. • No disclosure of transactions (other than cash flows) where an NPO determines that it is acting as an agent in a relationship or for a set of transactions. • Additional guidance on how control is determined and how to measure the asset held with specific examples to illustrate NPO arrangements. • Require disclosure of material agency relationships for an NPO, including: <ul style="list-style-type: none"> • a description of the entities or individuals involved in the relationship • a reconciliation from opening to closing balances of material agency transactions, • any major variances. | <p>Practical</p> <ul style="list-style-type: none"> • May be easier to implement given the simplified basis of considering risks and rewards. | <p>Technical</p> <ul style="list-style-type: none"> • Inconsistent with NPOs determining whether they are acting as agent or principal under a control framework. <p>Practical</p> <ul style="list-style-type: none"> • It might be difficult to provide examples that work and illustrate the relationships for all forms of NPOs. |

| | Description | Advantages | Disadvantages |
|---|---|---|---|
| <p>Alternative 3</p> <p>Follow IPSAS where decisions on agent and principal are made on an exposure to risks and rewards. Additional guidance and not for profit examples and with additional disclosure requirements.</p> | <ul style="list-style-type: none"> • NPOs would determine whether they were acting as principal or agent based on whether an NPO was exposed to significant risks or rewards in a transaction or relationship. • No disclosure of transactions (other than cash flows) where an NPO determines that it is acting as an agent in a relationship or for a set of transactions. • Additional guidance on how control is determined for agency and principal relationships with specific examples to illustrate NPO arrangements. • Require disclosure of material agency relationships for an NPO, including: <ul style="list-style-type: none"> • a description of the entities or individuals involved in the relationship • a reconciliation from opening to closing balances of material agency transactions, • any major variances. | <p>Practical</p> <ul style="list-style-type: none"> • May be pragmatically easier to implement. | <p>Technical</p> <ul style="list-style-type: none"> • Inconsistent with NPOs determining whether they are acting as agent or principal under a control framework. • May soon be out of date with the proposals to move to a control framework. |



Specific Matters for Comment 2

- 2.a** Do you agree with the description of issue 2: NPOs acting on behalf of other entities? If not, why not?
- 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.
- 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.
- 2.d** Please identify the alternative treatment that you favour for issue 2, and the reasons for your view.
- 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 disclosures that might be more relevant?



Section 2: Accounting for incoming resources

Issue 3: Non-exchange revenue

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Section 2: Accounting for incoming resources

Issue 3 – Non-exchange revenue

The recognition and measurement of revenue (in particular non-exchange revenue)³¹ has been identified as a specific issue for non-profit organisations.

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

- What are the overarching principles for the recognition and measurement of incoming resources from 'non-exchange' transactions?
- Timing of income recognition and definition of performance criteria/ obligation. What is the recognition and measurement process when receiving donations that are used to fulfil requirements in subsequent periods?
- When should donations to purchase a capital asset be recognised? What if the donation is repayable if the asset, at some future date, is no longer used for its intended purpose?
- When should services in-kind be recognised and if so, how are they measured? What disclosures should be provided?
- When should gifts in-kind be recognised and how should they be measured, including low value items such as inventory (second-hand for sale and new for distribution as part of charitable activities)?
- How should assets that can only be used for a specific purpose and may have to be returned be measured initially and subsequently?
- Recognition and measurement of 'right of use' donations (including free use of space and equipment)?

No sector specific issues regarding exchange revenue (ie revenue from commercial type arrangements such as providing services to third parties for a fee) were identified. Consequently, this section only considers non-exchange revenue.

It is not proposed that the issues associated with accounting for bequests is specifically covered in the initial Guidance and will be considered in a later phase.

³¹ Non-exchange revenue arises when an entity receives value from another entity without directly giving approximately equal value in exchange.

Issue 3: Non-exchange revenue

1. Description of the issue

- 1.1 NPOs receive non-exchange revenue from a variety of different resources.** NPOs 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. In this issue paper grants received/receivable, whether or not they have accompanying conditions are considered to be non-exchange revenues.
- 1.2 NPOs may also receive exchange revenue.** Exchange revenue is revenue earned from the sale of goods (eg merchandise) and services (eg health services, tuition fees and membership services), research and from the use of the entity's assets (eg interest, royalties and dividends). No sector-specific issues have been identified with exchange revenue. This issue paper considers the issues relating to non-exchange revenue only.
- 1.3 Revenue may appear to comprise both an exchange and non-exchange component in some transactions.** For example, a donor may receive goods after making a donation, but the value of these goods is clearly lower than the amount donated. This may raise a question about whether part of the donation is a purchase of goods (exchange). Similarly, an NPO may provide services such as healthcare or education for a charge that is less than the cost of providing the services because they are subsidised by grants. An NPO may face difficulties and/or additional costs if it is required to attribute incoming resources between these types of transactions.
- 1.4 Non-exchange revenue transactions raise specific issues.** These issues relate to the recognition, measurement and disclosure of non-exchange revenue.

Recognition (including timing where there are conditions and restrictions)

- 1.5 It may not be clear when an NPO is entitled to the resource** (cash or other assets) as there may be conditions (performance requirements) that require an NPO to use the incoming resources as determined by the donor. NPOs may not be entitled to the resources until they have performed these activities (for example, grants may be repayable if the related activity is not carried out).
- 1.6 A donor may impose restrictions on how the resources it has provided are used.** If the donor has imposed a restriction (either temporary or permanent), an NPO may be entitled to the funds but can only use the resources towards specific purposes.

- 1.7 Conditions and restrictions can create complexity for NPOs.** There are different views about when the stipulations imposed by a donor are a condition and when they are a restriction. Differing views lead to inconsistency in whether an NPO recognises revenue (through the statement of financial performance), or a liability for future performance (through the statement of financial position). Knowing when to recognise revenue can be a particular issue for multi-year grants.

Measurement

- 1.8 NPOs may find it difficult to estimate the value of some of the resources provided** and therefore how to record their value. This includes services in-kind and gifts in-kind (whether inventory items or other assets). Examples of the difficulties NPOs may experience include:
- Donated items may not have a readily available cost or market value, and may be specialised or have restrictions, making them difficult to value.
 - It may be impractical to value low value/high volume inventories provided for resale.
 - Donated items such as medical supplies may reach their expiry dates in the near future, making them difficult to value.
 - Capturing the volume and value of in-kind services can be challenging, particularly when these are volunteers providing general services.

Disclosure

- 1.9 Incorrect categorisation of incoming resources can lead to lack of transparency** about the funds/resources available for ongoing activities. Stakeholders might expect the accounts to show that the resources that they have provided have been used as they intended, and to disclose the restrictions imposed on donated resources.
- 1.10 Stakeholders use information to make decisions** and lack of transparency may impact understanding. Stakeholders want to understand what has happened to the resources they have provided but producing financial information that is useful may be challenging for a number of reasons including timing differences. The features of non – exchange transactions may make this more difficult.

2. Financial reporting challenges

- 2.1 Table 2.1 summarises the financial reporting challenges** and their significance (■ – high, ■ – medium and ■ – low) to each type of non-exchange revenue.

Table 2.1: Summary of paragraphs relevant to different types of non-exchange transaction

| Issue | Cash Transfers | Gifts In-Kind | Services In-Kind |
|------------------------------------|----------------|--------------------|--------------------|
| Recognition – control | 2.2 – 2.4 | 2.2-2.5 | 2.2 – 2.5 |
| Recognition – reliable measurement | | 2.6-2.8 | 2.9 |
| Recognition – timing | 2.0-2.14 | 2.10-2.12 and 2.15 | 2.10-2.12 and 2.16 |
| Measurement | | 2.17 and 2.18 | 2.17 and 2.19 |
| Disclosure | 2.20-2.22 | 2.20-2.22 | 2.20-2.23 |

Recognition (control)

- 2.2 Ascertaining control over resources provided might be challenging and at a disproportionate cost.** NPOs need to be certain that they have control over the resources provided for them to be recognised. For some types of resources (eg services in-kind) an NPO might need additional systems to ascertain the amount of resource it controls.
- 2.3 When donors can change their mind an NPO is not likely to control the asset.** Some donations are made through pledges or bequests, which do not bind the donor. Defining the point at which control passes, which is most likely to be when the asset has been received, will affect the timing of revenue recognition.
- 2.4 NPOs may need to determine what resource they control.** Where a donor provides an asset for an NPO to use and then return to the donor, an NPO will need to determine whether the donation is for the asset (a gift in kind) or a right to use the asset for a period (a service in kind).
- 2.5 Only services in-kind or outputs of services provided in-kind that are under the control of an NPO can be recognised.** An NPO can recognise revenue in respect of the services in-kind that have arisen because of something that happened in the past (a past event) and an NPO expects to get a future benefit to further its objectives. This can apply even if that future benefit is used straight away. NPOs need to have records and processes to demonstrate control.

Recognition (reliable measurement)

- 2.6 If an NPO cannot obtain a reliable measurement of the value of a donated item, an NPO will not be able to recognise any revenue** as a result of receiving the donated item. For an NPO to measure the value of a gift in-kind it needs to know the date that it took control of it and be able to determine a reliable estimate of its value at this date. The costs of obtaining a reliable value may be disproportionate to its value and outweigh the benefits that having a value will provide.

- 2.7 It may be impractical for an NPO to determine a reliable estimate for low value/high volume items given for resale.** As a consequence, no revenue would be recognised as the point that the donated items are received. In such circumstances, revenue could be recognised at a later point, ie when the items are sold, rather than when they are received.
- 2.8 It may be difficult to prepare a reliable estimate for items received for onward distribution even if the value of each item is known,** because some items may have a zero value if they cannot be used (ie because they have an expiry date) or sold. Practical difficulties can arise in determining what proportion of the items donated have a value, because it may not be possible to estimate the amount that can be used. The measurement of such items is discussed in issue paper 6 on the measurement of inventory held for use or distribution.
- 2.9 Similarly, if services in-kind cannot be measured, they cannot be recognised.** It can be difficult to reliably measure a service in-kind such as assigning a value to volunteers' time. For an NPO to recognise services in-kind as either an asset or an expense, an NPO must be able to reliably measure the service in-kind. Volunteers who donate their time for general activities that do not require specific qualifications or skills may be particularly difficult to measure, because it may be difficult to capture the number of hours and estimate the value of the services provided.

Recognition (timing)

- 2.10 Determining in which financial reporting period revenue should be recognised can be a challenge.** Revenue can only be recognised once any substantive performance requirements (conditions) have been satisfied. These are performance requirements that are most important and central to the arrangement. Revenue may need to be deferred if conditions have not been met.
- 2.11 NPOs may need to recognise a liability where resources have conditions.** The liability would represent an NPO's obligation to undertake the activities necessary to meet the conditions, or to return the resources to the donor. Judgements may be needed about the chances of having to refund revenue and when the likelihood of giving a refund diminishes from likely, to possible to unlikely. These judgements need to be quantified to determine the value of any liabilities that arise from these arrangements.
- 2.12 The substance of the conditions imposed need to be considered, not just their form.** Identifying the performance requirements or conditions and determining how they affect the recognition of an NPO's revenue can be a challenge. Guidance may be required on materiality and costs against benefits considered.
- 2.13 Stipulations attached to cash given for the construction of assets raise specific financial reporting challenges.** The requirement to use a capital

asset as intended may be for a set period, or open-ended. These terms may be considered a performance requirement (condition) with revenue deferred until the risk of repayment has reduced, or alternatively considered a restriction on the use of the asset, with revenue recognised immediately. If treated as a restriction, a subsequent change in use would trigger a repayment as a separate event. There may also be a challenge in understanding when a condition is met, over the period that the asset is constructed or acquired, or over the lifetime of the asset.

- 2.14 NPOs need to determine how much revenue to recognise when cash is received in arrears.** Some cash transfers are paid in arrears, with the cash transfer only falling due once conditions have been met (either in full or in part). NPOs with an expected entitlement may need to determine the amount of revenue to recognise and recognise a corresponding debtor for cash they are yet to receive.
- 2.15 It is possible that revenue is never recognised for items received for onward distribution.** As well as not recognising revenue on receipt of a donated item (see paragraph 2.8), revenue might also not be recognised subsequently if there are no proceeds. Where the value of individual items is known, revenue (and a corresponding expense) could be recognised when the item of inventory is used. This would provide more useful information about the cost of an NPO's activities.
- 2.16 An NPO that receives services in-kind and recognises revenue, will usually consume the benefits immediately.** This would lead to an expense and revenue being recognised when the services are received to reflect the use of the service provided. Services in-kind can also be provided for the construction of assets, in which case the cost of the asset being constructed should arguably include the value of the services in-kind.

Measurement

- 2.17 Measuring services or assets that have been gifted can be problematic.** Assigning value is not generally an issue for cash transfers but can be challenging where donations take the form of gifts in-kind or services in-kind.
- 2.18 Determining the value of donated capital assets, both tangible and intangible may be challenging and impact the amount of revenue.** For example, if housing donated to an NPO for social purposes could be sold for a higher price for use as commercial development it might be argued that the social housing is measured to reflect the value as commercial development land. This may not appropriately reflect the social nature of an NPO's objectives or the service potential that it might obtain from the asset.
- 2.19 Services provided on a commercial basis may be more easily measured than other services** as market prices may exist. Where a service would have

been purchased if it had not been donated, it may be more easily measured, and this is a stronger argument for recognition.

Disclosure

- 2.20 Allocating revenue that contains a mix of exchange and non-exchange revenue may be onerous.** Although this issue paper only considers non-exchange revenue, a requirement to identify the exchange and non-exchange components of a transaction might arise for recognition, measurement or disclosure purposes.
- 2.21 Standardising the presentation of revenue in the financial statements can assist understanding** of the sources of funding for an NPO. Revenue that has been recognised immediately, but is subject to restrictions, needs to be identified. Categorisation of revenue, particularly if there are different accounting treatments for different types of revenue is also important. Stakeholders may benefit from increased standardisation to access the information they need to understand the extent that revenue can be generally used to fund to an entity's expenditure. Financial statement presentation is discussed in issue paper 7.
- 2.22 Additional disclosures may be needed to provide transparency** and ensure that stakeholders have an accurate picture of an NPO's financial position. Disclosures about material amounts or activities, fundamental to the operations of an NPO, could be designed. This would enable users to have visibility of the nature, amount, timing and uncertainty of revenue as well as items that have not been recognised in the financial statements that could aid understanding for all stakeholders.
- 2.23 Additional disclosures are likely to lead to additional cost.** The costs of preparing additional disclosures may be disproportionate to the benefits. Some entities may also not have the resources to provide the information.

3. Current international guidance

- 3.1** Currently international guidance on the recognition and measurement of revenue is included in the following standards:³²
- IAS ® 20 *Accounting for Government Grants and Disclosure of Government Assistance*

³² There are a number of other standards that address revenue related accounting. This includes the accounting standards for leases (lease revenues), revenue from construction contracts (IPSAS only), insurance contracts, and provisions, contingent liabilities, and contingent assets. These are not included in the discussion of this topic. Similarly, accounting standards dealing with the recognition and measurement of assets are not included in the discussion of this topic.

- Section 23 and section 24 of the *IFRS for SMEs Standard*³³
 - IPSAS 23 *Revenue from Non-exchange Transactions* (Taxes and Transfers).
- 3.2** All standards support the gross reporting of inflows of economic benefits received and receivable by the entity on its own account.³⁴
- 3.3** All standards require the initial measurement of revenue to be based on fair value. Fair value may be ascertained by reference to an active market or by appraisal. Where an appraisal uses present value techniques, discounting may be required to reflect the time value of money. Exchange transactions are measured at the consideration received (after discounts) and non-exchange transactions are measured at the fair value at the date of acquisition.
- 3.4** Generally, the guidance provided by the standards is based on the core principle that revenue is recognised when it is probable that the entity will receive the economic benefits associated with the transaction and that it can be reliably estimated. This applies to revenue from exchange and non-exchange transactions. The guidance also requires that an entity has control over the asset (whether this is cash or other assets).
- 3.5** All standards require a minimum presentation of incoming resources. Further disclosures including the disaggregation of significant balances are required. For non-exchange transactions this goes to the nature and type of these transactions.

Non-exchange transactions

- 3.6** IAS 20 provides guidance on the accounting of revenue from government grants. Revenue from government grants is recognised on a systematic basis over the periods that the entity recognises as expenses the related costs that the grants are intended to compensate. IAS 20 allows grant revenue provided for capital assets to be recognised over the life of the asset, either by recognising deferred revenue in the statement of financial position, or by deducting the grant when determining the carrying amount of the asset.³⁵
- 3.7** The *IFRS for SMEs Standard* also addresses the treatment of government grants. Unlike IAS 20, the *IFRS for SMEs Standard* requires that a grant that imposes specified future performance requirements is only recognised as revenue as or when the performance requirements are met without an option to deduct the grant when determining the carrying amount of the asset.

³³ The International Accounting Standards Board has initiated a programme to review the *IFRS for SMEs Standard* and in particular to consider updates for standards issued since the last update. This includes IFRS 15 *Revenue from Contracts with Customers*.

³⁴ IAS 20 does however include an option to net a grant against the cost of an asset or the related expense.

³⁵ This standard allows the netting of expenses, which was permitted by the conceptual framework at the time. Netting of expenses is not permitted by the current IFRS conceptual framework.

- 3.8** The recognition criteria and measurement bases in the IFRS *Conceptual Framework* could be applied to other non-exchange revenue that are not government grants. Similarly, the recognition criteria and measurement bases in section 2 of the *IFRS for SMEs Standard, Concepts and Pervasive Principles* could be applied to other non-exchange revenue for those using the *IFRS for SMEs Standard*. Applying these concepts would in both cases result in revenue and an asset being recognised at fair value when an NPO controls a donated item. If a condition gives rise to a present obligation for an NPO, a liability (rather than revenue) may be recognised until the obligation has been satisfied (at which point the liability is derecognised and revenue recognised).
- 3.9** IPSAS 23 describes non-exchange transactions as those transaction where the 'entity receives value without directly giving approximately equal value in exchange'. This includes cash transfers. The standard defines separately conditions and restrictions which form stipulations. Under IPSAS 23, conditions include a 'use or return' requirement, ie the entity is required to return resources to the donor where the conditions are not met. Where conditions are attached to a cash transfer, a liability is recognised being the present obligation that arises because of the conditions. Restrictions are stipulations that do not have this use or return requirement. Where restrictions are attached to a cash transfer, no liability is recognised, and revenue is recognised immediately. The main difference between IPSAS 23 and the *IFRS for SMEs Standard* is that IPSAS 23 requires there to be a use or return requirement for a stipulation to be a condition; the *IFRS for SMEs Standard* does not.
- 3.10** The IPSASB has recently published ED 70, *Revenue with Performance Obligations*, and ED 71, *Revenue without Performance Obligations*. Under these proposals, revenue would be recognised when conditions are met. Where the cash has already been received, a liability is recognised until conditions have been met. Where the conditions are satisfied before the cash is received, an asset will be recognised. Unlike IPSAS 23, ED 71 does not require there to be a use or return requirement before revenue is deferred. In this respect, the proposals in ED 71 and the requirements in the *IFRS for SMEs Standard* are similar.
- 3.11** ED 71 explicitly addresses cash transfers to acquire or construct a capital asset. It proposes that revenue from such cash transfers would be recognised as the asset is either procured or constructed, and not over the useful life of the asset.
- 3.12** IPSAS 23 specifically addresses services in-kind. Entities are permitted, but not required, to recognise revenue from services in-kind. Entities are encouraged to disclose the nature and type of major classes of services in-kind received, including those that are not recognised.

Fair value

- 3.13** IFRS 13 sets out how to measure fair value but does not specify when fair value is to be used (this is addressed in other IFRS). Under IFRS 13, fair value is defined with reference to an exit price (that is, the price that could be achieved by selling the asset), assuming a highest and best use. Highest and best use takes into account any legal restrictions over an asset. Consequently, if a building was donated to an NPO with a restriction, the fair value would reflect that restriction.
- 3.14** In IPSAS, fair value³⁶ is defined in IPSAS 9 *Revenue from Exchange Transactions* as “the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.” This definition, by referring to an exchange rather than a sale, includes both exit values (best price from a sale) and entry values (cost of replacing the service potential an NPO will gain from using the asset).

4. National-level guidance³⁷

- 4.1** National standards have variously been converged on IFRS Standards, the *IFRS for SMEs* Standard or IPSAS, or set independently of international standards. The differences in revenue recognition between the international standards are therefore replicated to an extent in national standards. Jurisdictions may permit or require exceptions to the general recognition and measurement requirements for revenue, primarily in respect of gifts in-kind and services in-kind. They may also require specified disclosures. These vary across jurisdictions.
- 4.2** One jurisdiction provides guidance that is generally converged with the *IFRS for SMEs* Standard, with some additional options based on IFRS Standards. The guidance covers government grants, which can be accounted for using either the accrual model (based on IAS 20) or the performance model (based on the *IFRS for SMEs* Standard). Guidance is also provided on other non-exchange revenue; this guidance follows the performance model in the *IFRS for SMEs* Standard. This may result in government grants and cash transfers from other sources having different accounting treatments. To avoid this inconsistency, some sector specific guidance disallows the use of the accrual model. This jurisdiction also provides specific guidance for gifts in-kind and services in-kind:

³⁶ Having two definitions of fair value could be confusing, which is one of the reasons the IPSASB, in its Consultation Paper *Measurement*, proposed adopting a definition of fair value that is consistent with IFRS 13. The IPSASB has also proposed using an alternative term for those circumstances in which a current value using entry prices (the cost of replacing an asset’s service potential) will be necessary in the public sector.

³⁷ Additional information on national guidance of a limited number of jurisdictions can be found in Supplementary Information: International and national financial reporting standards and guidance.

- Entities must consider whether gifts in-kind can be measured reliably and whether the benefits of recognising the gifts in-kind as assets outweigh the costs. Where it is impractical to estimate the value of a donated item with sufficient reliability, no asset (and therefore no revenue) is recognised on receipt; revenue is recognised in the financial period that the donated item is sold. In the absence of an open market, a valuation may be derived from other sources, for example the cost to the donor, or the estimated resale value (after deducting costs to sell). Where items are distributed at no cost, an expense and revenue are recognised at the same time.
- Services in-kind are recognised as revenue and an expense when they can be measured reliably. Services that an entity would otherwise have purchased are recognised at the value to the entity; other services are recognised at a fair value. Disclosures are required where services in-kind are not recognised.

4.3 One jurisdiction provides guidance that is generally converged with IFRS Standards. Additional guidance is provided on the application of IFRS 15 to NPOs, particularly where services are provided to third-party beneficiaries. Additional guidance is provided on non-exchange revenue, which is recognised immediately except where the transaction requires an NPO to acquire or construct a non-financial asset. In these circumstances, revenue is recognised as the entity satisfies the conditions attached to the transfer (ie as the asset is acquired or constructed).

- No specific guidance is provided on the recognition of gifts in-kind (as opposed to in cash), although NPOs are encouraged to disclose inventory held but not recognised.
- An NPO can recognise volunteer services at fair value if they can be measured reliably, regardless of whether the services would have been purchased if they had not been donated. An NPO is encouraged to disclose information about volunteer services it receives, including those it has not recognised in the financial statements.

4.4 One jurisdiction provides guidance for NPOs generally converged with IPSAS, with some additional guidance for NPOs included. Simplified guidance is provided for smaller organisations but follows the principles in IPSAS 23; that is, donations are recognised immediately unless there are conditions including a use or return requirement. This standard setter also provides specific guidance for gifts in-kind and services in-kind:

- Guidance for larger organisations allows an option not to recognise gifts in-kind that meet the definition of inventories if it is not practicable to reliably measure their current value. Gifts in-kind for resale give rise to revenue when they are sold. No revenue is recognised in respect of gifts in-kind for distribution to beneficiaries. This can result in inventory not being included

in an NPO's balance sheet. Guidance from the same standard setter for smaller entities does not require revenue to be recognised for the receipt of gifts in-kind (although revenue would be recognised if goods were subsequently sold). A gift in-kind of a significant fixed asset is recognised as an asset and revenue.

- Larger entities may recognise volunteering services that can be reliably measured at fair value. For smaller entities recognition of volunteering services is optional, with a requirement for information about significant services received to be disclosed.

4.5 Two jurisdictions have developed national standards not based on international standards and require non-exchange revenue to be recognised immediately where the donations do not include conditions. In one jurisdiction where the donation does include conditions, revenue recognition is deferred only where a use or return requirement is attached to the condition. This approach is similar to that in IPSAS 23. Net assets with donor restrictions (ie where there is no use or return requirement) must be presented separately from net assets without restrictions.

- This jurisdiction does not permit or require any variation from fair value measurement but provides additional guidance on assessing fair value for gifts in-kind and donated fixed assets. NPOs are not required to recognise contributions of art, historical treasures, and similar items (sometimes referred to as heritage assets) if they are added to collections.
- Services in-kind are recognised (at fair value) where they either create or enhance a non-financial asset; or require skilled labour that would need to have been purchased if not provided by donation.

4.6 In the other jurisdiction where the donation includes conditions, the standard setter provides an accounting policy choice for the recognition of donations. One policy option permits donations with contributions to be recognised using a deferral method, where the donations are recognised in the period related to the corresponding expenses. This approach is similar to that in IAS 20 (where the cash transfer is not related to an asset). The alternative approach permits revenue to be recognised immediately, but presented as part of a separate restricted fund, which will also show the related expenses. This national standard setter is currently reviewing its guidance on contributions. This standard setter also provides specific guidance for gifts in-kind and services in-kind:

- An entity may choose to recognise contributed capital materials and services when current value can be reasonably estimated, and the materials and services are used in the normal course of operations and would otherwise have been purchased. Revenue in respect of a donated capital asset may be deferred and recognised on the same basis as the depreciation of the capital asset. This is similar to the approach in IAS 20.

Alternatively, the restricted fund method may be used.

- Services in-kind may be recognised at fair value if they can be measured reliably and would otherwise have been purchased for use in the normal course of operations or to construct an asset.

5. Alternative financial reporting treatments

- 5.1** The *IFRS for SMEs* Standard forms the starting point for the first alternative. IFRS Standards forms the starting point for the second alternative with the remaining two alternatives based on IPSAS.
- 5.2** NPO-specific guidance will be provided under all the alternatives, including guidance to assist in distinguishing between exchange transactions and non-exchange transactions.
- 5.3** The accounting basis proposed in each of the alternatives are summarised in Table 5.1.

Table 5.1: Summary of the main differences between alternatives

| | Framework for non-exchange revenue | Exceptions to the framework |
|----------------------|---|------------------------------------|
| Alternative 1 | The <i>IFRS for SMEs</i> Standard | No |
| Alternative 2 | IFRS Standards | No |
| Alternative 3 | IPSAS | No |
| Alternative 4 | IPSAS | Yes |

- 5.4 Alternative 1** requires all non-exchange revenue to be recognised in accordance with the *IFRS for SMEs* Standard. This would mean for non-exchange revenue other than government grants, that the *Concepts and Pervasive Principles* in the *IFRS for SMEs* Standard would be used to apply to other non-exchange transactions (ie NPOs would be required to recognise revenue from services in-kind and gifts in-kind where they can be reliably measured). Alternatively, the government grants requirements could be applied to other non-exchange revenue, as this is likely to result in similar accounting. Additional NPO-specific guidance would be provided.
- 5.5 Alternative 2** requires non-exchange revenue to be recognised using the principles in IAS 20 to extend the treatment of government grants to other non-exchange revenue (ie to recognise revenue on a systematic basis over the periods that the entity recognises as expenses the related costs). Additional NPO-specific guidance would be provided to enable the consistent treatment of all non-exchange revenue. As with alternative 1 in applying these principles

NPOs would be required to recognise revenue from services in-kind and gifts in-kind where they can be reliably measured.

5.6 Alternative 3 requires non-exchange revenue to be accounted for using the principles in IPSAS 23 (ie revenue is usually recognised when an NPO controls the assets but is deferred where there are conditions). Additional NPO-specific guidance would be provided. Consequently, the recognition of revenue from services in-kind would be encouraged but not mandatory, but all gifts in-kind would be required to be recognised where they can be reliably measured.

5.7 Alternative 4 requires non-exchange to be accounted for using the principles in IPSAS. In addition, exceptions drawn from various national standards would be considered for inclusion as part of NPO-specific guidance. The exceptions could:

- Permit NPOs to recognise revenue from gifts in-kind donated for resale at point of sale rather than on receipt, where measuring their value is impractical.
- Permit NPOs to not recognise inventory or revenue on receipt of gifts in-kind donated for distribution, where measuring their value is impractical.
- Permit NPOs to recognise revenue and an expense when items are distributed or used to provide services.
- Require additional disclosures where an NPO uses one of the permitted exceptions.

5.8 A specific matter for comment seeks views on whether the exceptions proposed in alternative 4 should be available in the other alternatives.

| | Description | Advantages | Disadvantages |
|---|--|---|--|
| <p>Alternative 1 Use recognition and measurement principles from the <i>IFRS for SMEs</i> Standard with additional NPO-specific guidance.</p> | <ul style="list-style-type: none"> Government grants are recognised as revenue as or when conditions (performance requirements) are satisfied. Other non-exchange revenue is recognised in accordance with the recognition criteria and measurement bases in the section 2, <i>Concepts and Pervasive Principles</i> (ie NPOs would be required to recognise revenue when an NPO controls the resources; this would also require the recognition of revenue from services in-kind and gifts in-kind where they can be reliably measured). Alternatively, the government grants requirements could be applied to other non-exchange revenue, as this is likely to result in similar accounting. No specific requirements for gifts in-kind or services in-kind (follow the same principles as other non-exchange revenue). | <p>Technical</p> <ul style="list-style-type: none"> Treatment of non-exchange transactions is consistent with IFRS Standards and follows without exception the <i>IFRS for SMEs</i> Standard. Treatment is broadly consistent with IPSAS. <p>Practical</p> <ul style="list-style-type: none"> Specific guidance may assist NPOs in their potentially complex arrangements. <p>Stakeholder</p> <ul style="list-style-type: none"> Provides a framework for recognising revenue and guidance that might aid consistency. | <p>Practical</p> <ul style="list-style-type: none"> NPOs may not have systems in place to recognise all services in-kind and gifts in-kind, particularly high volume, low value donations for resale and those services that would not otherwise been purchased. <p>Stakeholder</p> <ul style="list-style-type: none"> The treatment of government grants is inconsistent with grants from other providers, impairing comparability within an NPO's financial statements. <p>Cost/benefit</p> <ul style="list-style-type: none"> The cost of recognising and measuring all gifts in-kind and services in-kind on receipt may outweigh the benefits, particularly for smaller NPOs. |

| | Description | Advantages | Disadvantages |
|--|---|---|---|
| <p>Alternative 2</p> <p>Recognise all non-exchange revenue using the principles in IAS 20. NPO-specific guidance is provided.</p> | <ul style="list-style-type: none"> All non-exchange revenue is recognised on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. All gifts in-kind and services in-kind are recognised on receipt (subject to any conditions being satisfied and it being possible to measure them reliably). | <p>Technical</p> <ul style="list-style-type: none"> Follows the <i>IFRS for SMEs</i> Standard. The treatment of non-exchange revenue is consistent with treatment of government grants in IAS 20. <p>Practical</p> <ul style="list-style-type: none"> Specific guidance may assist NPOs in their potentially complex arrangements. The options available in IAS 20 may offer options that are easier to implement (eg netting capital grants received against cost of the asset). <p>Stakeholder</p> <ul style="list-style-type: none"> Provides a framework for recognising revenue and guidance that might aid consistency. | <p>Technical</p> <ul style="list-style-type: none"> Not consistent with the <i>IFRS for SMEs</i> Standard or IPSAS for non-exchange revenue. <p>Practical</p> <ul style="list-style-type: none"> NPOs will need to be able to estimate the period in which related expenses will be recognised. NPOs may not have systems in place to recognise all services in-kind and gifts in-kind, particularly high volume, low value donations for resale and those services that would not otherwise been purchased. <p>Stakeholder</p> <ul style="list-style-type: none"> Comparability and transparency may be reduced if different entities take different approaches to non-exchange guidelines. <p>Cost/benefit</p> <ul style="list-style-type: none"> The cost of recognising and measuring all gifts in-kind and services in-kind on receipt may outweigh the benefits, particularly for some NPOs. |

| | Description | Advantages | Disadvantages |
|---|---|--|--|
| <p>Alternative 3</p> <p>Recognise non-exchange revenue using the principles in IPSAS 23. NPO-specific guidance is provided.</p> | <p>Non-exchange revenue is recognised as conditions (performance requirements) are satisfied. Conditions always include a ‘use or return’ requirement.</p> <p>All gifts in-kind are recognised on receipt (subject to any conditions being satisfied and it being possible to measure them reliably).</p> <p>NPOs are encouraged but not required to recognise services in-kind.</p> | <p>Technical</p> <ul style="list-style-type: none"> • Consistent with IPSAS and draws on guidance specifically written for non-exchange transactions. • Broadly consistent with the <i>IFRS for SMEs</i> Standard. <p>Practical</p> <ul style="list-style-type: none"> • Pragmatic approach, particularly for those smaller NPOs that may have difficulty measuring revenue from services in-kind at the point of receipt. <p>Stakeholder</p> <ul style="list-style-type: none"> • Increased consistency of revenue recognised for revenue with conditions. • Greater disclosure of non-exchange transactions. | <p>Technical</p> <ul style="list-style-type: none"> • Not consistent with IFRS Standards. <p>Stakeholder</p> <ul style="list-style-type: none"> • Allowing a choice of accounting policy for services in-kind may mean that NPOs’ financial statements are not comparable with other NPOs. <p>Cost/benefit</p> <ul style="list-style-type: none"> • The cost of recognising and measuring all gifts in-kind on receipt may outweigh the benefits, particularly for smaller NPOs. |
| <p>Alternative 4</p> <p>Recognise non-exchange revenue using the principles in IPSAS 23. Introduce exceptions to the requirements for gifts in-kind based on some national standards. NPO-specific guidance is provided.</p> | <ul style="list-style-type: none"> • All non-exchange revenue is recognised as conditions (performance requirements) are satisfied. Conditions always include a ‘use or return’ requirement. • Permit NPOs to recognise revenue from gifts in-kind donated for resale at point of sale rather than on receipt, where measuring their value is impractical. • Permit NPOs to not recognise inventory or revenue on receipt of gifts in-kind donated for distribution, where measuring their value is impractical. Permit NPOs to recognise revenue and an expense when items are distributed or used to provide services. • Permit (but do not require) NPOs to recognise services in-kind as revenue and an expense. • Require additional disclosures where an NPO uses one of the permitted exceptions. | <p>Technical</p> <ul style="list-style-type: none"> • Core recognition principles consistent with treatment of government grants in the <i>IFRS for SMEs</i> Standard. • Draws on guidance specifically written for non-exchange transactions <p>Practical</p> <ul style="list-style-type: none"> • Pragmatic approach, particularly for those smaller NPOs that may have difficulty measuring revenue from gifts in-kind and services in-kind at the point of receipt. <p>Stakeholder</p> <ul style="list-style-type: none"> • Increased consistency of revenue recognised where there are conditions. • Additional disclosures may overcome differences in recognition of gifts in-kind and services in-kind in the financial statements. • Provides a framework for recognising revenue and guidance that might aid consistency. <p>Cost/benefit</p> <ul style="list-style-type: none"> • Exceptions may reduce or avoid additional costs. | <p>Technical</p> <ul style="list-style-type: none"> • Not consistent with IFRS Standards. • Drawing on different frameworks might create gaps or lead to conceptual inconsistencies. <p>Stakeholder</p> <ul style="list-style-type: none"> • The use of exceptions may lead to lack of transparency. |



Specific Matters for Comment 3

- 3.a** Do you agree with the description of issue 3: Non-exchange revenue? If not, why not?
- 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.
- 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.
- 3.d** Please identify the alternative treatment that you favour for issue 3, and the reasons for your view.
- 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?
- 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?



Section 3: Accounting for outgoing resources (expenses and liabilities)

Issue 4: Grant expenses

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Section 3: Accounting for outgoing resources (expenses and liabilities)

In earlier research relatively few issues were identified that relate to the accounting for outgoing resources. In addition to grant expenses, described below, three other topics have been identified as having financial reporting challenges that are relevant to the accounting for outgoing resources.

One of the topics concerns the treatment of expenses when an NPO is acting on behalf of another organisation as an agent. This topic has both income and expense implications and as it relates to the relationship between entities it is presented alongside the topic on the reporting entity (issue 2).

Two of the topics; classification of expenses (issue 8) and fundraising costs (issue 9) are primarily concerned with the presentation and disclosure of financial information rather than how to account for these costs. These have been included with the other topics that relate to the presentation, scope and content of financial information.

Issue 4 – Grant expenses

Many NPOs make grants to other organisations to further their (the donor NPO's) objectives. This topic is primarily concerned with what expense should be recognised and when and to related disclosures.

Issue 4: Grant expenses

1. Description of the issue

- 1.1 NPOs can award grants to other entities (including other NPOs) or individuals.** Grants can be purely cash or comprise cash and other assets. Grants may take the form of a 'promise to pay', potentially over multiple reporting periods, as well as the immediate transfer of cash to the recipient.
- 1.2 Grants arrangements can be complex, involving multiple agencies.** For example, NPOs may award grants to NPOs (grant recipients) who in turn pass the funds and other assets on to other NPOs with only the final grant recipient providing specific services to service users. The final grant recipient will be the body carrying out the activity or function. These types of arrangements may create separate obligations for each grant awarding body. There will be different recognition points for grant expenses depending on the specifics of the transactions.

Recognition

- 1.3 A grantor may be unsure when to recognise all or part of the grant expense because of multiple obligations on the recipient.** The obligations could require an NPO to perform either specific activities or generic activities as a condition to be entitled to receive the grant. For example, a grant may be given to provide health services for a period (generic activities) or to carry out a number of inoculations of school children (specific). In some cases, it may not be clear whether the terms of a grant impose an obligation on the grant recipient, for example, when the terms require the grant recipient to use the grant to meet the grant recipient's objectives.
- 1.4 Understanding where a grantor's obligations end in practice creates a further challenge.** For example, if an entity does not comply with the grant conditions, questions are likely to arise as to whether an obligation to pay the grant continues to exist, or whether some or all of the grant has to be refunded.
- 1.5 There can be a significant period of time before the grantor is able to confirm the activities have been performed.** Grant awarding bodies will not certify completion of a specific grant or project until the end of a grant awarding period. A grantor may not be certain that the recipients of the grant have met all of the conditions until this is complete. This can lead to uncertainty about recognition for financial statements preparers.

Disclosure

- 1.6 Donors and other stakeholders will wish to have a clear understanding of an NPO's expenses, obligations and commitments.** Lack of guidance on grants may lead to inconsistency, which users of NPO financial statements may find causes difficulties in assessing financial performance. Guidance would provide clarity particularly where these grants are awarded through complex organisational arrangements, or over time. Guidance may also be beneficial for accounts preparers.

2. Financial reporting challenges

- 2.1 Grant expenses are not currently explicitly covered in international accounting standards,** being non-exchange transactions. With no specific guidance on grant expense transactions to assist NPOs with recognition and measurement, the accounting treatment of grant expenses can be a significant issue for NPOs.

Recognition

- 2.2 Difficulties arise because it is not always clear what has been promised to a grant recipient and what commitments have been created.** As grants can be awarded over multiple financial reporting periods an NPO will need to consider whether the whole amount should be recognised as an expense immediately or not recognised until the reporting period for which the grant is intended. Measurement issues may also arise when the time value of money is significant.
- 2.3 Significant judgement may be required to determine when a grant expense should be recognised.** Grantors may impose conditions on the grant recipient which impact when a grant is recognised. Where these are documented in a grant agreement, recognition decisions may be clearer, but where no grant agreement exists this may be more challenging. Some conditions may be more significant than others, which can also impact on the consideration of whether or not the conditions have been met.
- 2.4 When the grant is paid before conditions are met, particular issues can occur.** There might be two different circumstances:
- Conditions relate to how the grant is spent – in these cases the grantor may need to assess whether the conditions are met (which might take place in stages) or are likely to be met.
 - Conditions relate to how items acquired by the grantee for the purposes of the grant programme continue to be used or if items are sold.
- 2.5 A separate transaction may need to be recognised where there is an obligation to return an asset.** It is not normally the case that an awarding

body includes return conditions or stipulations. There may be legal barriers to the return of grants or contributions. However, when a grant agreement includes return conditions, the awarding entity may need to consider if it has an asset prior to the grant recipient satisfying its obligations under the grant agreement.

- 2.6 Identifying an obligating event between parties in order to recognise a grant expense may be challenging.** This need exists whether the relationship from grantor to recipient is direct (ie from grantor to recipient) or indirect (ie from grantor NPO, to an intermediate NPO to the recipient). Indirect relationships make the transactions more complex. Additionally, any intermediate NPO will need to consider whether it is acting as agent in the transaction or whether it is acting as principal in awarding the grant to the recipient.
- 2.7 Depending on the timing of the transfer/cash payment, an NPO may need to recognise an accrual or a provision in its accounts.** Where the grant recipient has met the grant conditions or when the grant has no conditions, an NPO will need to accrue these amounts. NPOs will need to consider each promise made to grant recipients separately. A portfolio approach to such grants may be possible in some instances.
- 2.8 It is likely that there will be a contingent liability when an NPO has made a promise but cannot measure its value.** An NPO may have committed to make a grant payment (and has created an obligation) but the payment cannot be measured (perhaps because these are staged payments and the latest stage is not measurable). If it can be measured, then it would be a provision as set out in paragraph 2.7 above. Contingent liabilities would be disclosed in the financial statements.

Disclosure

- 2.9 Disclosure about grants paid and commitments is important to stakeholders to provide transparency.** Disclosures about commitments not yet reflected in the accounts is important, particularly for NPOs that make significant grants. Consideration also needs to be given to the presentation of grants in the Statement of Financial Performance. An NPO will need to consider whether an analysis of expenses by nature or by function provides the best information to stakeholders.

3. Current international guidance

- 3.1** Currently international guidance does not explicitly deal with grant expenses. Current guidance rests under the general provisions for the recognition of provisions and the reporting of contingent liabilities within IFRS, the *IFRS for SMEs* Standard and IPSAS:

- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
 - Section 21 *Provisions and Contingencies* – the *IFRS for SMEs* Standard
 - IPSAS 19 *Provisions, Contingent Liabilities and Assets*.
- 3.2** Under these standards an expense for a grant and a liability would be recognised when an NPO has a present obligation to fund another entity created by a past event, ie a commitment (or a constructive obligation), and the amount of the grant can be reliably measured. Recognition of the grant would take place when an NPO has no realistic alternative other than to settle an obligation to pay the grant (and it is therefore probable that there will be an outflow of resources).
- 3.3** When an expense is recognised it follows the relevant standards' requirements for presentation, measurement and disclosure of the expense and cross reference needs to be made to nature/function of expenses.
- 3.4** The timing of the recognition of a grant would be dependent on any conditions included in the grant (ie when the conditions are such that there would be no realistic alternative to settling the obligation to pay the grant). If there are no conditions and an obligation has been created, then the grant would need to be recognised as an expense in the reporting period when the obligation was created. When the time value of money is significant the grant would need to be recognised at present value.
- 3.5** As the current guidance does not explicitly address grant expenses, the existing standards do not provide specific guidance to cover performance obligations imposed by a grantor, nor does the guidance address the obligation made by the grantor, when agreeing to a grant.
- 3.6** IPSASB has a current project on Transfer Expenses which explicitly provides guidance for grant expense transactions. ED 72 *Transfer Expenses* defines a transfer expense an expense arising from a transaction, other than taxes, in which an entity provides a good, service, or other asset to another entity (which may be an individual) without directly receiving any good, service, or other asset in return.
- 3.7** ED 72 addresses recognition and measurement of performance obligations, distinguishing between where the transfer recipient is required to satisfy performance obligations by transferring goods or services to a third-party beneficiary and where the transfer recipient is not required to satisfy performance obligations. ED 72 also provides guidance which would address the accounting for multi-year grants.

4. National-level guidance³⁸

- 4.1 A number of the jurisdictions follow international standards ie either IFRS Standards or IPSAS provisions following the accounting treatments for the recognition of the grants as outlined above in Section 3 of this issue paper.
- 4.2 Other jurisdictions are based on the same or similar provisions and provide additional guidance. One set of national guidance takes the general approach to the recognition of liabilities/provisions for grantors, but also explicitly includes the concept of performance obligations.
- 4.3 This national GAAP requires a liability and an expense to be recognised when a commitment has been made as long as the definition and recognition criteria for a liability have been satisfied, the obligation is such that the entity cannot realistically withdraw from it, and the entitlement of the other party does not depend on performance-related conditions.
- 4.4 Another jurisdiction has issued guidance on how to account for contributions made and received. It defines a promise to give as a written or oral agreement to contribute cash or assets to another entity. A promise to give may be either conditional or unconditional. Contributions made are recognised as expenses in the period made (immediately if unconditional, or once any conditions are met) and as decreases of assets or increases of liabilities depending on the form of the benefits given.

5. Alternative financial reporting treatments

- 5.1 Largely, international standards and national standards require an entity to recognise a liability and an expense when a grantor is committed to provide resources to the grant recipient (individual, organisation or entity). Some jurisdictions include provisions that explicitly refer to performance obligations or where the grant is conditional or has conditions that need to be met.
- 5.2 **Alternative 1** is based on either IFRS Standards, the *IFRS for SMEs* Standard or IPSAS with additional guidance to assist NPOs with NPO-specific issues. This would include recommended additional disclosures. The guidance could be prepared to align with one of these international frameworks, but in line with Part 1: Chapter 5, the preference would be the *IFRS for SMEs* Standard.
- 5.3 **Alternative 2** builds on alternative 1 but requires that the principles being proposed in IPSAS ED 72 *Transfer Expenses* are incorporated. Incorporating these principles would provide additional guidance on grants with performance obligations and multi-year arrangements.

³⁸ Additional information on national guidance of a limited number of jurisdictions can be found in Supplementary Information: International and national financial reporting standards and guidance.

| | Description | Advantages | Disadvantages |
|--|--|---|--|
| <p>Alternative 1</p> <p>Follow international standards (either IFRS Standards, the <i>IFRS for SMEs</i> Standard or IPSAS) and include additional guidance on recognition, measurement and disclosure including performance related conditions.</p> | <ul style="list-style-type: none"> Recognise a liability and an expense for the grant when an obligation has been created. Provide additional guidance on performance related conditions. Provide additional guidance on multi-year grants. Provide guidance on the disclosure of grants and related commitments. | <p>Technical</p> <ul style="list-style-type: none"> No departures from international standards. <p>Practical</p> <ul style="list-style-type: none"> Additional guidance will provide relevant information to allow NPOs to decide when they have an obligation to pay a grant. Additional guidance may assist NPOs decide how to recognise multi-year schemes. | <p>Stakeholder</p> <ul style="list-style-type: none"> Lack of comparability across NPOs due to different interpretations. |
| <p>Alternative 2</p> <p>Follow either IFRS Standards, the <i>IFRS for SMEs</i> Standard or IPSAS, include additional guidance on recognition, measurement incorporating the performance obligation approaches proposed in ED72 by IPSASB, when IPSAS is not used as the base.</p> | <ul style="list-style-type: none"> Recognise a liability and an expense for the grant when an obligation has been created. Provide additional guidance on performance related conditions. Provide additional guidance on multi-year grants. Provide guidance on the disclosure of grants and related commitments. Specify that the grant awarding NPO will disclose significant transactions such that all users will understand the transactions and the commitments made by the grant awarding NPO. | <p>Technical</p> <ul style="list-style-type: none"> Guidance from IPSAS may assist recognition decisions. <p>Practical</p> <ul style="list-style-type: none"> Additional guidance may assist NPOs decide how to recognise multi-year schemes. <p>Stakeholder</p> <ul style="list-style-type: none"> Increased comparability of grant reporting across NPOs. | <p>Technical</p> <ul style="list-style-type: none"> May create departures from IFRS Standards or the <i>IFRS for SMEs</i> Standard for complex arrangements with multiple performance obligations. |



Specific Matters for Comment 1

- 4.a** Do you agree with the description of issue 4: Grant expenses? If not, why not?
- 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.
- 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.
- 4.d** Please identify the alternative treatment that you favour for issue 4, and the reasons for your view.



Section 4: Accounting for financial and non- financial assets

| | |
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Section 4: Accounting for financial and non-financial assets

A number of issues have been identified in earlier research that relate to non-financial assets. The topics include specialised assets held by NPOs, heritage assets, concessionary leases and service concession arrangements. There are also issues relating to financial assets, particularly concessionary loans.

Two of the topics (see below) are proposed for inclusion in the initial Guidance as they meet all four criteria for prioritisation. The remainder will be addressed as a later date.

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.

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.

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

1. Description of the issue

- 1.1 **NPOs use a wide range of assets in delivering services.** These can include such diverse assets as community facilities, warehouses or hospital buildings and equipment. The measurement of tangible assets (property, plant and equipment) in the non-profit sector may be more difficult than in the commercial sector because NPOs are far more likely to hold these assets for their service potential ie for social and public benefit purposes rather than for their economic or financial return.
- 1.2 **Assets might generate some cash inflows, even where they are primarily held for social and public benefit purposes.** For example, an NPO may run a community centre which offers classes for which it receives fees or provide classes free for all of the community. Although the community centre in this example is generating cash flows, an NPO's charitable objectives are such that it is doing so for social purposes.
- 1.3 **Issues might arise in determining the boundary between assets held for operational purposes and assets held for investment purposes.** For example, where an NPO has assets which are rented out, such as housing this could be for social benefit or to generate financial returns. This determination will depend on the objectives that an NPO has for the use of the asset.
- 1.4 **It may be important for stakeholders to understand the assets that are used to provide the services,** particularly their operating capacity. Donors and other funders may be particularly interested in understanding the position for assets to which they have contributed, and therefore how effectively their donations (and other funds) have been used.

Initial measurement

- 1.5 **NPOs may find it more difficult to record assets that have been donated.** NPOs may be readily able to measure an asset on acquisition if purchased or constructed itself. This is because it should have a full understanding of the original cost and any subsequent costs used to maintain or enhance the asset. However, both recognition and measurement can be more challenging were the asset has been donated.
- 1.6 **Sometimes it can be difficult to determine whether an NPO has rights to the benefits in the assets.** This may in turn lead to complexities in measurement particularly where the asset is given to an NPO for a time limited period or for

a particular task/project. This paper, however, does not consider these types of arrangements (right-of-use assets) where they are effectively a lease.

Impairment

- 1.7 The value to an NPO from services that are supported by the assets may reduce if the assets become damaged or deteriorate (impairment).** Depreciation schedules may need to be revisited or this may provide an indication that the asset should be subject to an impairment review. Also, the donor of an asset that has effectively been loaned, may require it to be returned earlier than originally expected, which will impact the value of the services that can be provided.
- 1.8 It may be difficult to measure impairments where an NPO are using assets for their service potential rather than to maximise economic returns.** Where assets are impaired NPOs must ensure that the carrying amount does not exceed what it can get for that asset. In many cases the cash flows received for a building such as the example of the community centre in paragraph 1.2, where cashflows are used to estimate the value of the asset to an NPO, would not reflect the value of that use to an NPO.

2. Financial reporting challenges

Initial measurement

- 2.1 Assets purchased or constructed are expected to be recognised at historical cost on initial recognition.** When an NPO acquires property, plant and equipment it needs to be included as an asset (initial recognition) on the statement of financial position (balance sheet), whether or not it generates revenue.
- 2.2 All assets will remain recognised as on their balance sheets even where they are not cash-generating,** assuming that the assets are being fully utilised by an NPO to fulfil the objectives of an NPO (ie they have service potential). Service potential includes the use made by an NPO of an asset to deliver its objectives for the organisation's purposes.
- 2.3 An estimate of the value of donated assets needs to be derived.** There can be challenges to determine an initial value as there have been no cost to an NPO. Establishing an appropriate value may be particularly challenging where an asset is donated that provides either more capacity or a higher specification than is needed by an NPO. The discussion of non-exchange revenue (issue paper 3) also considers donated assets.

Subsequent measurement

- 2.4 Entities need to decide how to continue measuring the asset** once an asset has been recognised. International accounting standards require that asset values are updated at regular intervals (subsequent measurement). This can be either at historical cost (the 'cost model') or at a revalued amount. This is an important decision that needs to reflect the needs of an NPO's stakeholders.
- 2.5 Historical cost as a basis of subsequent measurement spreads the initial cost of an asset over its useful life to the entity.** Accumulated balances show the 'cost yet to be consumed'. Historical cost may be attractive for use in subsequent measurement due to its ease of use and understandability for users. It provides a direct link to the transactions undertaken by an NPO.
- 2.6 Measuring some assets using historical cost may not reflect their usefulness to an NPO.** Assets being held by NPOs are to provide services to service users and not principally for the income or economic returns they generate or their market value (the price for which an asset can be sold). A valuation that reflects the value of the assets to the business, for example, the cost of replacing the output of an asset may be more appropriate. If the value of an asset increases because of greater potential service provision, this would not be recognised in historical cost measurements.
- 2.7 Measuring assets using the revaluation model may be costly.** NPOs would need to maintain asset valuations so that they are materially accurate at the reporting date. This may require substantial resource input from NPO staff and the input of valuation experts which may be cost prohibitive, particularly for smaller NPOs. In addition, NPOs will need staff who are sufficiently skilled to be able to draft instructions for the valuers.
- 2.8 Assets that might be measured a 'highest and best use' could far exceed the operational value to an NPO** leading to difficulties in the application of the revaluation model. For instance, offices might be able to be converted into high value residential accommodation, but this use would not be within the purposes of an NPO. Measurement using the revaluation model may also raise questions of how depreciation should be charged and how impairment can be identified and measured, particularly where the overall value of an asset is increasing.
- 2.9 Similar measurement issues may arise for intangible assets,** although these are less likely to be material or occur as frequently.

Impairment

- 2.10 An annual impairment review is needed where there are indicators of impairment irrespective of whether the cost or revaluation model is**

used to assess whether the asset has a value lower than its carrying amount. An NPO may have difficulty in measuring the impairment as it may not have cash flow information from which impairments may be estimated. Where an NPO uses the revaluation model and is able to measure its value in use under that model, impairments are likely to be reflected through a deterioration in the service potential. This may require significant judgements by NPO management and is likely to require experts to provide these measurements.

Disclosure

- 2.11 It may be important to donors and other stakeholders to understand the operational capacity of assets** when assessing the performance of particular services or activities to which they may have contributed. Where a valuation shows the operational capacity of an asset it could allow users to understand the real cost of consuming the resources provided by the assets to deliver services rather than what an NPO might have paid for them. However, where NPOs use the revaluation model, it needs to be clear how the information provided in the valuations contribute to stewardship and accountability.
- 2.12 NPOs will need to explain the measurement bases it is using when disposing of assets to help users of the financial reports** where this is material. Where an asset becomes surplus to requirements the sale/ disposal price may be materially different to the carrying value of the asset. Stakeholders will want to understand the difference between the economic value achieved on disposal and the value an NPO has derived from its use.

3. Current international guidance

- 3.1** International standards for the measurement of tangible assets and leases are:
- The *IFRS for SMEs* Standard sections 17 and 27
 - IAS 16 *Property, Plant and Equipment*
 - IPSAS 17 *Property, Plant and Equipment*
 - IFRS 13 *Fair Value Measurement*
 - IAS 36 *Impairment of Assets*
 - IPSAS 21 *Impairment of Non-Cash Generating Assets*
 - IPSAS 26 *Impairment of Cash Generating Assets*

Property, plant and equipment

- 3.2** The property, plant and equipment standards, including the *IFRS for SMEs* Standard, require that assets are initially measured at cost.
- 3.3** IAS 16, IPSAS 17 and the *IFRS for SMEs* Standard offer entities the choice of subsequently measuring property, plant and equipment using either the cost model or at the revalued amount and stipulate that this policy must be applied to the entire class of assets.

- 3.4** The standards also require that revaluations are made with sufficient regularity to ensure that the carrying amount would not be materially different from that which would be determined using fair value at the end of the reporting period.
- 3.5** The revaluation model under international standards requires entities to measure property plant and equipment at fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

Fair value

- 3.6** IFRS Standards determine that assets (or liabilities) measured at fair value must follow the measurement and disclosure requirements under IFRS 13 *Fair Value Measurement*. Fair value is defined in IFRS 13 as:

“The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.”

For non-financial assets, IFRS 13 requires that assets are measured at ‘highest and best use’. IFRS 13 provides guidance on the techniques that are permitted by the standard ie the market approach, the cost approach (which would allow in certain circumstances for measurement at depreciated replacement cost) and the income approach.

- 3.7** The *IFRS for SMEs* Standard or IPSAS do not have separate dedicated measurement standard or equivalent for fair value and both use a different definition of fair value from that included in paragraph 3.6. IPSAS 17 establishes that the fair value of a property is usually determined by market-based evidence by appraisal. The *IFRS for SMEs* Standard uses a hierarchy to estimate fair value based on market prices. Both the IASB³⁹ and IPSASB⁴⁰ have current projects that are considering the impact of IFRS 13.
- 3.8** Under IPSAS 17, in cases where there is no market-based evidence of fair value because of the specialised nature of the asset, an entity may estimate fair value using the approaches of reproduction cost, depreciated replacement cost, restoration cost or service units.
- 3.9** An important part of understanding the value of an asset to a public service entity is the concept of service potential this is described in the IPSASB *Conceptual Framework*⁴¹ as the capacity to provide services that contribute to achieving the

³⁹ The International Accounting Standards Board has commenced a review of the *IFRS for SMEs* Standard and in particular to consider updates for standards issued since the last update. This will include IFRS 13 *Fair Value Measurement*.

⁴⁰ The International Public Sector Accounting Standards Board has recently consulted on measurement across all IPSAS. The IPSASB is considering the definition of fair value as part of its measurement project.

⁴¹ The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities, IPSASB, October 2014.

entity's objectives. The 'value in use' measurement is more likely to reflect the value of services supported and thus its service potential for an entity.

Impairment

- 3.10** IAS 36 *Impairment of Assets* requires that an assessment is made at the end of each reporting period whether there is any indication that an asset may be impaired. It provides a list of indicators of impairment to assist with this assessment. If there is an indication that an asset may be impaired, then the asset's recoverable amount must be estimated. The recoverable amount is the higher of an asset's fair value (less costs of disposal), and its value in use.
- 3.11** IPSASB has issued two standards on impairment IPSAS 26 *Impairment of Cash Generating Assets* (based on IAS 36) and IPSAS 21 *Impairment of Non-Cash Generating Assets* drafted for public sector circumstances. IPSAS 21 defines recoverable amount as the higher of a non-cash-generating asset's fair value (less costs to sell) and its value in use, with value in use being the present value of the asset's remaining service potential.

4. National-level guidance⁴²

- 4.1** National-level guidance is consistent with either the IFRS Standards or IPSASB requirements for initial recognition and measurement, subsequent measurement and impairment. Therefore, the reporting requirements depend on the framework adopted. One jurisdiction follows the IPSAS approach but augments this with guidance on the estimation of fair value using the depreciated replacement cost method which is used frequently by public benefit entities.
- 4.2** One jurisdiction does not permit the revaluation model. In this GAAP, as with IFRS Standards, an asset is impaired if an asset or a group of assets' carrying amount is more than its recoverable amount. The recoverable amount is measured at the undiscounted future cash flows that are directly associated with and that are expected to arise as a result of the use and the eventual disposition of the asset or the asset group.
- 4.3** In this jurisdiction the impairment of fixed assets for NPOs normally follows the same accounting treatment as commercial entities with one exception, which, rather than establishing a non-cash-flow focused recovery test to determine whether an item of property, plant and equipment is impaired, discusses how contribution subsidies would be factored into a cash-flow focused test.
- 4.4** Another jurisdiction generally follows the *IFRS for SMEs* Standard initial and subsequent measurement. It is similar on impairment and sets out that if (and

⁴² Additional information on national guidance of a limited number of jurisdictions can be found in Supplementary Information: International and national financial reporting standards and guidance.

only if) the recoverable amount of an asset is less than its carrying amount, an entity is required to reduce the carrying amount of the asset to its recoverable amount. That reduction is an impairment loss. The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell and its value in use.

- 4.5** This jurisdiction's standards specifically include the concept of service potential in the measurement of the value in use when measuring the recoverable amount and states:

"For assets held for their service potential, a cash flow driven valuation (such as value in use) may not be appropriate. In these circumstances value in use (in respect of assets held for their service potential) is determined by the present value of the asset's remaining service potential plus the net amount the entity will receive from its disposal."

5. Alternative financial reporting treatments

- 5.1** The measurement of property, plant and equipment is consistent across standards regarding initial recognition; historical cost for assets purchased or constructed and fair value for donated assets. These provisions therefore feature in all alternatives. There are, however, different approaches that can be taken to their subsequent measurement and impairment. The alternatives focus on these potential differences.
- 5.2** The alternatives are based on national and international standards. This includes one jurisdiction that does not allow the revaluation model to be used. The use of the cost model is included in all alternatives noting it may have limitations for presenting information on the use of an asset for service provision.
- 5.3** **Alternative 1** follows existing international standards (IFRS Standards, the *IFRS for SMEs* Standard and IPSAS), permitting either the cost or revaluation model for subsequent measurement. It includes additional guidance for NPOs, particularly on impairment. The measurement bases available would be those permitted in the relevant standards.
- 5.4** **Alternative 2** follows existing international standard as alternative 1, but permits the use of an additional measurement base, 'value in use' within the revaluation model. This would allow the concept of service potential available in IPSAS to be applied to all classes of assets.
- 5.5** **Alternative 3** would not allow the revaluation model and would require all property, plant and equipment to be subsequently measured using the cost model. In this model the fair value determined for donated assets would be used as a proxy for historical cost. This would be an amendment to all three

international accounting frameworks. Disclosures of an alternative value would not be required as this imposes the additional cost of valuation.

- 5.6 Alternative 4** mandates the use of the revaluation model (and a 'value in use' measurement) for land and buildings to ensure that the asset's measurement reflect the operational capacity rather than the financial capacity of the asset.
- 5.7** Revaluation using a 'value in use' could be appropriate for this class of assets reflecting the value an NPO would derive for the provision of specific services such as medical treatment, refuge centres, youth centres, etc. This approach uses the valuation approaches in IPSAS. All other classes of assets would retain the choice, with value in use available where the revaluation model is chosen.

| | Description | Advantages | Disadvantages |
|---|--|---|---|
| <p>Alternative 1</p> <p>Subsequent measurement of property, plant and equipment follows either the cost model or the revaluation model, with additional NPO-specific guidance.</p> | <ul style="list-style-type: none"> Initial measurement at historical cost. Donated assets to be measured initially at fair value and subsequently in accordance with the relevant class of property, plant and equipment. For subsequent measurement, provide NPOs with the choice to value classes of assets using the cost or the revaluation model. Where assets are subject to impairment, they should be measured at the lower of carrying value and recoverable amount. Provide additional NPO-specific guidance, particularly to assist with impairment reviews. | <p>Technical</p> <ul style="list-style-type: none"> Follows existing international standards. <p>Practical</p> <ul style="list-style-type: none"> Additional guidance to show how the principles apply. <p>Stakeholder information</p> <ul style="list-style-type: none"> NPOs will be able to choose the model in accordance with the needs of their users and which best represents the measurement of its assets. Provides transparency about the cost of the use of assets for service provision where the revaluation model is used. <p>Cost/benefit</p> <ul style="list-style-type: none"> Allows NPOs to choose the most cost-effective option. No change to existing arrangements and therefore should be cost neutral. | <p>Stakeholder information</p> <ul style="list-style-type: none"> Where an NPO chooses to use the cost model, this may limit the usefulness of information particularly in demonstrating the value of its use to an NPO for the provision of services. Comparability may be limited if similar organisations use different models. <p>Cost/benefit</p> <ul style="list-style-type: none"> Revaluation may increase depreciation charges. |

| | Description | Advantages | Disadvantages |
|---|--|---|---|
| <p>Alternative 2</p> <p>Subsequent measurement of property plant and equipment follows either the cost model or the revaluation model and includes an additional measurement base (value in use) under the revaluation model – with additional NPO-specific guidance on how to measure the service potential in those assets to be measured at ‘value in use’.</p> | <ul style="list-style-type: none"> Initial measurement at historical cost Donated assets to be measured initially at fair value and subsequently in according with the relevant class of property, plant and equipment. For subsequent measurement provide NPOs with the choice to value classes of assets using the cost or the revaluation model. Alongside fair value measurement, allow for another measurement base, ‘value in use’ so that NPOs can measure the service potential of assets from which they provide services. Where assets are impaired, they should be measured at the lower of carrying value and recoverable amount. Provide additional NPO-specific guidance, particularly to assist with impairment reviews. | <p>Practical</p> <ul style="list-style-type: none"> Additional guidance to show how the principles apply. <p>Stakeholder information</p> <ul style="list-style-type: none"> Allows assets to be valued to reflect their service potential so that users understand the resources consumed in the use of assets by the services or activities provided. NPOs will be able to choose the model in accordance with the needs of their users and which best represents the measurement of its assets. <p>Cost/benefit</p> <ul style="list-style-type: none"> Allows NPOs to choose the most cost-effective option. | <p>Technical</p> <ul style="list-style-type: none"> Value in use is not used explicitly in international standards (but discussed in both IASB and IPSASB Conceptual Frameworks) so, aligned with alternative 4 financial reporting and/or regulatory frameworks may not allow measurement at ‘value in use’. <p>Practical</p> <ul style="list-style-type: none"> Difficulty in providing guidance on the measurement of service potential across different types of NPOs. <p>Stakeholder information</p> <ul style="list-style-type: none"> Where an NPO chooses to use the cost model, this may limit the usefulness of information particularly in demonstrating its use to an NPO for the provision of services. Comparability may be limited if similar organisations use different models. <p>Cost/benefit</p> <ul style="list-style-type: none"> Revaluation may increase depreciation charges. |

| | Description | Advantages | Disadvantages |
|--|---|---|--|
| <p>Alternative 3</p> <p>Subsequent measurement of property plant and equipment using the cost model – with additional NPO-specific guidance</p> | <ul style="list-style-type: none"> Initial measurement at historical cost. Donated assets to be initially measured at fair value (as an estimate of historical cost). Subsequent measurement using the cost model. Where assets are impaired, they should be measured at the lower of carrying value and recoverable amount. Provide additional NPO-specific guidance, particularly to assist with impairment reviews. | <p>Practical</p> <ul style="list-style-type: none"> Additional guidance to show how to apply the principles. <p>Stakeholder information</p> <ul style="list-style-type: none"> Relatively simple and may be more easily understood by stakeholders and donors. Allows for comparability. <p>Cost/benefit</p> <ul style="list-style-type: none"> More cost effective to produce. | <p>Technical</p> <ul style="list-style-type: none"> Lack of choice is not consistent with international accounting standards Increases in the value of an asset are not recognised in historical cost measurements <p>Stakeholder information</p> <ul style="list-style-type: none"> Does not offer a choice about how to best represent the value of the assets. May not fully present information about the operating capacity of the assets to support service delivery. |
| <p>Alternative 4</p> <p>Require certain classes of assets where they are used for their service potential to be measured using the revaluation model at a 'value in use' measurement basis. For the remaining classes of assets (plant and equipment) allow a rebuttable presumption that assets measured at historical cost is a proxy for the revalued asset.</p> | <ul style="list-style-type: none"> Initial measurement at historical cost. Donated assets to be measured initially at fair value and subsequently in accordance with the relevant class of property, plant and equipment. Require classes of property to be measured using the revaluation model at a 'value in use' measurement base where those assets are used to provide services. Allow a rebuttable presumption that the classes of plant and equipment are measured at historical cost as a proxy for the revalued asset. Where assets are impaired, they should be measured at the lower of carrying value and recoverable amount. Provide additional NPO-specific guidance, particularly to assist with impairment reviews. | <p>Technical</p> <ul style="list-style-type: none"> Assets values reflect the operational capacity of the most material assets. <p>Practical</p> <ul style="list-style-type: none"> Additional guidance to show how to apply the principles should promote consistency and ease of application. <p>Stakeholder information</p> <ul style="list-style-type: none"> Improves users' understanding of resources consumed by allowing assets most materially impacted by revaluation to be valued to reflect their service potential. Allows comparison of performance between NPOs on one class of assets, which will be useful for decision making purposes for donors and other stakeholders. | <p>Technical</p> <ul style="list-style-type: none"> Value in use is discussed in both the IASB and IPSASB Conceptual Frameworks but not explicitly defined. <p>Practical</p> <ul style="list-style-type: none"> NPOs may not have the resources or skills to commission valuations. <p>Stakeholder</p> <ul style="list-style-type: none"> Comparability may be limited if similar organisations use different models for other asset classes. <p>Cost/benefit and technical</p> <ul style="list-style-type: none"> Likely to be costly and increase the reporting burden, particularly for smaller NPOs. May increase depreciation charges. |



Specific Matters for Comment 5

- 5.a** Do you agree with the description of issue 5: Measurement of non-financial assets held for service benefit? If not, why not?
- 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.
- 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.
- 5.d** Please identify the alternative treatment that you favour for issue 5, and the reasons for your view.
- 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?

Issue 6: Inventory held for use or distribution

1. Description of the issue

1.1 NPOs hold a wide variety of inventory. Examples include medical supplies, textbooks, food, clothing, fuel, furniture, equipment, and leaflets. NPOs may hold inventory for commercial purposes, for example, items held for sale in shops to generate revenue to support the work of an NPO. NPOs may also hold inventory to be used directly in meeting their objectives. Such inventory may be held for direct distribution to service users or may be held for use by an NPO in delivering services.

Measurement

1.2 NPOs will need to determine which costs should be included in the carrying amount of own produced inventory. An NPO may produce the inventory itself, taking raw materials and developing them into a finished product, for example using paper and inks to produce information leaflets. In such examples NPOs will need to determine their materiality and have processes to measure stock levels.

1.3 NPOs may not have inventory management systems that allow them to record low value/high volume inventories and it may be impractical to do so. NPOs can receive donations of low value/high volume inventories provided for resale. They may have difficulty in both keeping records of items and assigning a value to each item.

1.4 Donations that are intended for onward distribution to service users may only have a value for a short period. For example, pharmaceutical organisations can donate vaccinations to be used as part of aid programs, or food can be donated to provide meals for the homeless. These kinds of donations can be made when the item being donated needs to be used within a defined period because it has a short expiry date. While it might be easier to keep records for these items it may not be possible for an NPO to estimate whether they can all be used.

1.5 NPOs may be part the way through the provision of services and have work in progress usually included in inventories. An example would be where an NPO prepares legal casework to support refugees and asylum seekers. Until a case is heard, the casework may meet the recognition criteria for inventory. Unless record keeping systems (such as timesheets) are in place, NPOs may find it difficult to determine the cost of these items of inventory.

1.6 It may be impractical to maintain records of inventory movements for all items. The value of inventory, whether held for sale or held for use or distribution, will need to be updated as new inventory is added or as inventory

is sold, distributed, or used. For some items of inventory (eg services such as pro-bono legal work) individual values may be recorded, but for other items this may not be practicable or possible. For example, where an NPO stores all its fuel in a tank, it will not be possible to separately identify the fuel that relates to a particular delivery. Where individual records are not appropriate, a costing formula will need to be used. Formulas that are commonly used are first in, first out (FIFO) and weighted average.

- 1.7 NPOs may not be able to demonstrate the value that comes from donations and the need for them to continue** because of difficulties in measuring some items of inventory. These difficulties may lead to differences between NPOs in how inventory is reflected in financial statements. Stakeholders may find it difficult to understand how an NPO is delivering its services if an NPO does not record donated inventory.

2. Financial reporting challenges

- 2.1 There are no issues that are unique to NPOs for purchased inventory.** Where an NPO acquires inventory by purchasing the inventory itself, the cost of the inventory will be straightforward to determine. While there may be challenges for some NPOs in determining the cost of own produced inventory, issues are unlikely to be unique to NPOs.

Recognition

- 2.2 If the cost of an item cannot be measured reliably, then no inventory (asset) is recognised.** Items of inventory are normally recognised as assets in the balance sheet and initially measured at cost, provided that their cost can be measured reliably. If items are not recognised as inventory (assets) in the balance sheet, this will impact how the use of the items are recognised (expense) and the value of the donation provided (revenue). This is considered in issue paper 3 on non-exchange revenue.

Initial measurement

- 2.3 There are more significant challenges in reliably measuring the cost of donated items as there is no purchase cost.** Instead, the fair value of the items is used as their deemed cost when recognising inventory (assets). For an NPO to be able to reliably measure the deemed cost (fair value) of the items that have been donated it needs to know the date that it took control of each item, and be able to determine a reliable estimate of its value at this date. If an NPO cannot obtain a reliable measurement it may not be able to recognise the item as inventory in its balance sheet.
- 2.4 It may not be possible to recognise donations for resale as inventory in the balance sheet when they are received.** Items donated for resale can be high in volume and low in value. As is discussed in issue paper 3 on non-

exchange revenue, it may be possible to recognise revenue at a later date if the items are sold. There is also the question of whether/how to account for donations that are not suitable for resale; if these have been recognised as inventory, it may be necessary to impair the items.

- 2.5 An estimate of the value of the inventory may be too uncertain to be reliable.** It may be difficult to prepare a reliable estimate of the fair value of items donated for distribution to service users or for an NPO's own use (including for administrative purposes). Practical difficulties can arise in determining whether all of the items donated have a value, even if the value of each item is known, because the uncertainties over usage.
- 2.6 Assessing the fair value of the items may impose costs or administrative burdens** on some NPOs. Some NPOs may find the keeping of inventory records challenging, particularly if they do not have an inventory control system. The cost of assessing the fair value might be disproportionate to the value of the item and exceed the benefit derived from being able to recognise the items as inventory.
- 2.7 An alternative method of assessing the value of the inventory may be required.** The value to the entity of inventory held for commercial purposes (for example, greetings cards purchased for resale) can be assessed by reference to the expected sales proceeds. However, there may be no, or nominal, sales proceeds associated with other inventory held for use or distribution.

Subsequent measurement

- 2.8 Determining subsequent values for types of inventory (whether this value derives from sales, distribution, or use) may be challenging.** After initial recognition, inventory is subsequently measured to ensure that its value does not exceed the value that can be obtained from the inventory. If items are not recognised as inventory in the balance sheet, then no issues of subsequent measurement will arise.

Impairment

- 2.9 Inventory will need to be written down (impaired), where the carrying amount of the inventory exceeds its value to the entity.** Impairing inventory relies on being able to determine the value to the entity. For similar reasons to those relating to recognition and initial measurement, this may also create a financial reporting challenge.

3. Current international guidance

3.1 Currently international guidance on the measurement of inventory held for use or distribution is included in the following standards:

- IAS 2 *Inventories*
- Section 13 the *IFRS for SMEs* Standard
- IPSAS 12 *Inventories*.

Measurement

3.2 IAS 2 and Section 13 of the *IFRS for SMEs* Standard require inventory to be measured initially at cost, and subsequently at the lower of cost and estimated selling price less costs to complete and sell (also referred to as net realisable value). Entities are required to assess whether the cost of the inventory exceeds its estimated selling price less costs to complete and sell at each reporting date. Where the cost is greater than the estimated selling price less costs to complete and sell, the inventory is written down to the estimated selling price less costs to complete and sell. The *IFRS for SMEs* Standard refers to this as impairment, but the process is the same in both IAS 2 and the *IFRS for SMEs* Standard.

3.3 IPSAS 12 has similar requirements; however, IPSAS 12 does not apply to work-in-progress of services to be provided for no or nominal consideration. Entities are required to develop their own accounting policies for such transactions, for example, expense the work as it is undertaken.

3.4 The measurement requirements in IPSAS 12 are the same as IAS 2. IPSAS 12 is more explicit in its requirements in two areas. Donated inventory is initially measured at fair value (this is discussed in issue paper 3 on non-exchange revenue). Inventory held for use or distribution is subsequently measured at the lower of cost and current replacement cost.

3.5 IAS 2, Section 13 of the *IFRS for SMEs* Standard and IPSAS 12 provide guidance on the elements of the cost of inventory, and on allocating overheads. Fixed overheads are allocated based on normal capacity; variable overheads are allocated based on actual usage. They permit the use of techniques such as the standard costing method or the retail method where these approximate to cost.

3.6 Where items of inventory are not valued individually, IAS 2, Section 13 of the *IFRS for SMEs* Standard and IPSAS 12 require the use of either the FIFO or weighted average cost formulas. The last in first out formula (LIFO) is not permitted.

Impairment

- 3.7** Under IAS 2, Section 13 of the *IFRS for SMEs* Standard and IPSAS 12, the value of inventory is assessed at the end of the reporting period. Where the value of inventory is below its cost, it is written down to its selling price less costs to complete and sell (or, in the case of inventory held for use or distribution under IPSAS 12, its current replacement cost). The amount of the write-down, which is referred to as the impairment loss in the *IFRS for SMEs* Standard, is recognised as an expense.

4. National-level guidance⁴³

- 4.1** While national-level guidance and standards can be converged on IFRS Standards, the *IFRS for SMEs* Standard or IPSAS, or set independently of international standards, there is consistency on the core principles around accounting for inventory. There are, however, differences between jurisdictions about the measurement of inventory held for use or distribution. Issue paper 3 on non-exchange revenue provides additional information about approaches taken by national standard setters to donated inventory.
- 4.2** One jurisdiction is based on IAS 2, with some amendments for non-profit entities. This national standard does not apply to work-in-progress of services to be provided for no or nominal consideration. Guidance is provided for measuring donated inventory. Inventories held for use or distribution are measured at cost, adjusted (ie impaired) when applicable for any loss of service potential. The guidance notes that for many items of inventory, “a loss of service potential would be identified and measured based on the existence of a current replacement cost that is lower than the original acquisition cost or other subsequent carrying amount.” Where inventory is acquired in a non-exchange transaction, current replacement cost is used as the cost of the inventory.
- 4.3** One jurisdiction has a standard based on the *IFRS for SMEs* Standard, with some amendments. Guidance is provided for measuring donated inventory. Inventories held for use or distribution are measured at the lower of cost, adjusted (impaired) when applicable for any loss of service potential and replacement cost.
- 4.4** One jurisdiction has a standard based on IPSAS 12 with guidance provided for measuring donated inventory. Unlike IPSAS 12, inventory held for use or distribution is measured at cost, adjusted (impaired) when applicable for any loss of service potential.
- 4.5** One jurisdiction has issued a general standard on inventories that is not based on international standards but is broadly consistent with IAS 2 and the *IFRS for*

⁴³ Additional information on national guidance of a limited number of jurisdictions can be found in Supplementary Information: International and national financial reporting standards and guidance.

SMEs Standard. This standard setter has also issued a separate standard on inventories held by non – profit organisations. This standard includes guidance on donated inventories. Inventories held for use or distribution are measured at the lower of cost and current replacement cost (in other words, inventory is impaired when the current replacement cost is lower than the cost of the inventory).

- 4.6** One jurisdiction has a standard that is not based on international standards but is broadly consistent with IAS 2 and the *IFRS for SMEs* Standard, although it permits the use of the last in first out (LIFO) costing formula, albeit with specific impairment provisions. The scope of the standard does not provide any specific guidance for NPOs.

5. Alternative financial reporting treatments

- 5.1** Both international and national accounting standards adopt similar principles for accounting for inventories. Differences between the standards relate to whether specific provisions are required for donated assets, the application of the standard to work-in-progress of services provided at no cost, and the measurement (impairment) of inventory held for use or distribution. The initial measurement of donated inventory is considered in issue paper 3 on non-exchange revenue.
- 5.2** Some standards do not include specific guidance on the measurement (impairment) of inventory held for use or distribution. Where guidance is included, the two approaches adopted are to measure inventory at the lower of cost and current replacement cost; and to measure inventory at cost, adjusted when applicable for any loss of service potential. In some cases, a loss of service potential will be indicated by a current replacement cost that is lower than cost, so there is some overlap in the approaches adopted in the standards. These approaches have informed the development of the alternative approaches in this issue paper.
- 5.3** Measuring work-in-progress of services to be provided at no cost may be challenging for some NPOs. For this reason, the alternative approaches that include specific provisions for inventory held for use or distribution permit such work-in-progress to be expensed as incurred.
- 5.4** **Alternative 1** is based on the requirements of IFRS Standards (IAS 2) and the *IFRS for SMEs* Standard, with additional guidance for NPOs, but no divergence from the requirements of these standards. This guidance could cover situations where it may be more practical for NPOs to apply general materiality principles and expense items as they are acquired.
- 5.5** **Alternative 2** is based on the requirements of IPSAS (IPSAS 12) and allows work in progress for no or nominal consideration to be expensed and provides

for inventory for distribution to be valued at the lower of cost and current replacement costs, with additional guidance for NPOs.

- 5.6 Alternative 3** is based on the requirements of IPSAS 12 (as alternative 2) but requires that inventory for distribution is valued at the lower of cost and current service potential. This valuation technique is not permitted by any current international standards but is required by one jurisdiction as part of its national standards. As with alternatives 1 and 2, additional guidance would be provided.
- 5.7** Under all three alternatives, NPOs face a practical issue in that they may not have the systems needed to capture all inventory.

| | Description | Advantages | Disadvantages |
|--|---|--|--|
| <p>Alternative 1 Measure all inventory at the lower of cost or net realisable value with additional NPO-specific guidance.</p> | <ul style="list-style-type: none"> • Inventory measured at the lower of cost or selling price (less costs to complete). • No specific provisions for the measurement of donated inventory and inventory held for use or distribution. • Additional NPO-specific guidance and examples on applying the general provisions for inventory; on measuring inventory held for use or distribution; and on when inventory could be expensed as acquired on materiality grounds. | <p>Technical</p> <ul style="list-style-type: none"> • Fully compliant with IFRS Standards and the <i>IFRS for SMEs</i> Standard. <p>Practical</p> <ul style="list-style-type: none"> • Specific guidance may assist NPOs in their potentially complex arrangements. <p>Cost/benefit</p> <ul style="list-style-type: none"> • Guidance may assist in cost of preparation. | <p>Practical</p> <ul style="list-style-type: none"> • Challenge of determining materiality. <p>Stakeholder</p> <ul style="list-style-type: none"> • The writing down of inventory held for distribution to zero may obscure transparency unless the service potential (eg replacement cost) is disclosed. <p>Cost/benefit</p> <ul style="list-style-type: none"> • Measuring work-in-progress of services to be provided at no cost and inventory held for use or distribution may be costly. |
| <p>Alternative 2 Require inventory held for use or distribution to be measured at the lower of cost or current replacement cost .</p> | <ul style="list-style-type: none"> • Inventory held for use or distribution is measured at the lower of cost or current replacement cost. • No specific provisions for the measurement of donated inventory. • Permit work-in-progress of services to be provided at no or nominal cost to be expensed as incurred. • Additional NPO-specific guidance and examples on applying the general provisions for inventory; and on when inventory could be expensed as acquired on materiality grounds. | <p>Technical</p> <ul style="list-style-type: none"> • Fully compliant with IPSAS. • Current replacement cost is more appropriate than estimated selling price where inventory is not sold. <p>Practical</p> <ul style="list-style-type: none"> • Specific guidance may assist NPOs in their potentially complex arrangements. <p>Stakeholder</p> <ul style="list-style-type: none"> • Provides a consistent approach to measuring inventory held for use or distribution. <p>Cost/benefit</p> <ul style="list-style-type: none"> • Guidance may assist in considering cost/benefit of approaches. | <p>Technical</p> <ul style="list-style-type: none"> • May not be consistent with IFRS Standards and the <i>IFRS for SMEs</i> Standard. <p>Practical</p> <ul style="list-style-type: none"> • Current replacement cost may be difficult to determine where donated. <p>Stakeholder</p> <ul style="list-style-type: none"> • May lead to inconsistent treatment of work-in-progress of services to be provided at no or nominal cost. • Transparency may be impacted without disclosures on inventory not recognised in the financial statements. |

| | Description | Advantages | Disadvantages |
|---|---|---|--|
| <p>Alternative 3 Require inventory held for use or distribution to be measured at cost, adjusted when applicable for any loss of service potential, with disclosure of the accounting policy and impact on service delivery.</p> | <ul style="list-style-type: none"> • Inventory held for use or distribution is measured at cost, adjusted when applicable for any loss of service potential. • Permit work-in-progress of services to be provided at no or nominal cost to be expensed as incurred. • Require disclosure relating to the calculation of the loss of service potential, (including where this reduces service potential to zero) and the significance to the meeting of organisational objectives. • Additional NPO-specific guidance and examples on applying the general provisions for inventory; and on when inventory could be expensed as acquired on materiality grounds. | <p>Practical</p> <ul style="list-style-type: none"> • Adjusting cost for loss of service potential (eg obsolescence) may be easier to determine than current replacement cost. <p>Stakeholder</p> <ul style="list-style-type: none"> • Provides a consistent approach to measuring inventory held for use or distribution. • More relevant information for stakeholders • Improved transparency about the impact on service delivery. <p>Cost/benefit</p> <ul style="list-style-type: none"> • Guidance may assist in considering cost/benefit of approaches. | <p>Technical</p> <ul style="list-style-type: none"> • May not be consistent with IFRS Standards, the <i>IFRS for SMEs</i> Standard and IPSAS. <p>Practical</p> <ul style="list-style-type: none"> • Determining service potential may be challenging. <p>Stakeholder</p> <ul style="list-style-type: none"> • May lead to inconsistent treatment of work-in-progress of services to be provided at no or nominal cost. • Differing assessments of loss of service potential may lead to inconsistent treatments and obscure transparency. |



Specific Matters for Comment 6

- 6.a** Do you agree with the description of issue 6: Inventory held for use or distribution? If not, why not?
- 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.
- 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.
- 6.d** Please identify the alternative treatment that you favour for issue 6, and the reasons for your view.



Section 5: Presentation, content and scope of financial reports

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Section 5: Presentation, content and scope of financial reports

Earlier research identified that additional information would help with the understanding of accounts and the presentation of the accounts themselves could be improved. Topics included the reporting of remuneration, related party transactions and foreign currency transactions (which are not prioritised for inclusion in the initial guidance), as well as the presentation of financial statements and narrative reporting, which are considered further below. This section also includes the classification of expenses and fundraising costs, which are primarily concerned with the presentation of financial information.

Issue 7 – Financial statement presentation

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?

Issue 8 – Classification of expenses – function or nature

NPOs can present their expenses by nature or by function, with at least one jurisdiction 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?

Issue 9 – Fundraising costs

Raising funds is critical to the existence of many NPOs. They can take many forms and there is a question about where to report the costs of doing so.

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

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

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 its 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?

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

1. Description of the issue

- 1.1 The financial statements provide information to a wide range of stakeholders.** They provide information about an NPO's financial performance, financial position and cash flows, are a key document for holding an NPO to account, and for making economic decisions.
- 1.2 It may not be clear which resources and reserves reported in the financial statements can be used by an NPO for its ongoing activities,** and which can only be used in relation to the purposes for which they were given. The nature of NPOs and the way many NPOs are funded raise some unique financial reporting issues. These impact the content and the presentation of financial statements. In particular, the fact that NPOs receive funding that has conditions or restrictions (stipulations) attached may mean that an NPO is not free to use its resources as it wishes. This may be relevant to stakeholders' understanding of the financial statements.
- 1.3 Some donations may be in the form of an endowment, which must be invested.** While an NPO can use the interest earned from the investment, the capital itself cannot be used by an NPO. Again, this limitation may not be clear from the financial statements.
- 1.4 Stakeholders may have different views about what information should be included in the financial statements.** Some donors may be looking for information in a particular format. For example, a donor that has provided funding with a condition may wish to see a statement that shows the cash received from the donation and the cash payments made with that donation, which goes beyond the information included in most financial statements. Information about the cash receipts and payments in respect of individual donations is not usually visible in financial statements.
- 1.5 Donors may be seeking additional information that supports their assessment of the use of the donations.** This may be a particular issue where the donation is only intended to cover part of a project's costs. Donors may be seeking information about expenses that have been committed but not yet incurred, and which is therefore not yet recognised in the financial statements. Additionally, donors who permit services in-kind received by an NPO to count against the total cost of a project may be unable to confirm these amounts, even if such amounts are recognised in the financial statements.
- 1.6 NPOs may have difficulty in knowing when it is appropriate to create separate reserves and how to manage them.** Some funds or reserves

may only be used for specific purposes because of restrictions imposed by the donor. In other cases, NPOs may decide to set aside other amounts for specific purposes for internal management reasons. This includes setting aside amounts to create capacity to deal with unforeseen events or emergencies, or to purchase capital assets. Reporting significant transfers between reserves may obscure an NPO's performance, particularly if funds are transferred to reserves in years when there is a surplus but withdrawn and used for an NPO's ongoing operations if there is a deficit in the year.

2. Financial reporting challenges

- 2.1 General purpose financial statements are necessarily an aggregation of an entity's transactions.** Financial statements result from processing large numbers of transactions or other events that take place in a financial reporting period. It is highly unlikely that an individual transaction is identifiable in the financial statements.
- 2.2 Attempting to provide all the information stakeholders may wish to see in the financial statements may lead to complex, costly requirements.** Providing varying perspectives on the same transactions may also confuse users of the financial statements. It will be necessary to consider the extent to which stakeholder's differing views can be accommodated in general purpose financial statements that are intended to meet the needs of many stakeholders. General purpose financial statements are generally prepared from the reporting entity's perspective. Balancing the competing needs of different stakeholders must be considered.
- 2.3 Stakeholders will be seeking a range of information about an NPO's financial and non-financial performance.** The focus of this issue paper is on the general-purpose financial statements that contain financial performance information. Part 1 of this Consultation Paper discusses the users of the financial statements, and the reporting entity, and this issue paper should be read in the light of those discussions. Non-financial information is considered in issue paper 10 on narrative reporting.
- 2.4 Separating funds that distinguish between the net assets that are restricted for a particular purpose and those that can be used for any purpose could provide greater transparency.** Some assets may need to be used for particular purposes and others at the discretion of an NPO. The nature of the different types of funds that make up an NPO's net assets provide a financial reporting challenge.
- 2.5 Maintaining separate financial statements for each type of fund or reserve (fund accounting)** could address this problem. Presenting each fund or reserve may be feasible where an NPO has a very limited number of restricted funds. However, as the number of funds increases, so will the

complexity of the financial statements, which may make them more difficult to understand. Financial statements could become larger in volume, which could be mitigated if funds are aggregated into similar types of fund or reserve in the financial statements. While this may increase transparency, it could increase the costs for NPOs. Consideration may also need to be given as to whether some funds are separate reporting entities.

- 2.6 It may be more difficult to provide a fund presentation with some financial statements.** The income statement generally lends itself to a fund presentation. The financial position statement (balance sheet) could show the fund balances separately; but presenting fund balances for assets and liabilities could be far more challenging.
- 2.7 Stakeholder needs could be met by a cashflow that shows the source and application of funds.** The preparation of a cash flow statement separated by fund (analysing receipts and payments for each fund) could meet the needs of stakeholders who want to understand what has happened to their donation. It would require all cash receipts and payments to be recorded by fund, which may be challenging because of system limitations, cost and effort. There is also the question of whether this is appropriate for general purpose financial statements that are intended to be used by a wide range of stakeholders.
- 2.8 Disclosing the accounting treatment for donations that have conditions could assist users.** Some donors may expect an NPO to recognise revenue for the donations that they have made and may be confused if they are not able to see this revenue in the income statement. Users may not understand that, where a donation has a condition, a liability will have been recognised and the revenue deferred.
- 2.9 Timing issues could be explained in the notes to the financial statements.** Where a donation has been recognised in one financial year, but the related expense does not happen until a subsequent financial year, users may not understand the misalignment between these transactions.
- 2.10 Reserve management is primarily a financial management issue,** however, disclosure of an NPO's policies on reserves may help stakeholders understand management's decisions. If an NPO decides to set aside other amounts for specific purposes for internal management reasons, reporting these separately from an NPO's other finances can provide greater transparency about an NPO's operations and the amounts available to fund its ongoing operations. NPOs may find it helpful to have guidance on when reserves should be created and how they should be managed.

3. Current international guidance

3.1 Currently international guidance on the presentation of financial statements is included in the following standards:⁴⁴

- IAS 1 *Presentation of Financial Statements*⁴⁵
- IAS 7 *Statement of Cash Flows*
- Sections 3 – 8 the *IFRS for SMEs Standard*⁴⁶
- IPSAS 1 *Presentation of Financial Statements*
- IPSAS 2 *Cash Flow Statements*

3.2 Under IFRS Standards and the *IFRS for SMEs Standard*, a complete set of financial statements includes the following: statement of financial position; income statement (either a statement of comprehensive income, or separate income statement and comprehensive income statement); statement of changes in equity; statement of cash flows; and notes to the financial statements. The statement of cash flows may be presented using the direct or the indirect method.

3.3 These standards provide that, in these statements, assets, liabilities, income and expenses should be broken down into material categories, with such information needed to give stakeholders a full picture of an entity's financial position and performance.

3.4 IPSAS uses some different terminology, but otherwise has similar requirements. One difference is that the income statement (the statement of financial performance) in IPSAS does not include other comprehensive income. The gains and losses presented in other comprehensive income under IFRS Standards or the *IFRS for SMEs Standard* are presented in the statement of changes in net assets/equity under IPSAS.

3.5 IFRS Standards, the *IFRS for SMEs Standard* and IPSAS include guidance on the format of each statement such as the material categories of assets and liabilities to be reported. They also include further guidance on topics such as comparative information, materiality, and the aggregation or disaggregation of information. The examples in these standards present the statement of financial position (the balance sheet) using a vertical presentation. Under this presentation, assets are presented first, with liabilities below assets, followed

⁴⁴ Other standards also include presentation and disclosure requirements. These are not included in the discussion of this topic.

⁴⁵ The IASB has issued Exposure Draft ED/2019/7 *General Presentation and Disclosures* that proposes amendments to the format and content of the financial statements to be presented under IAS 1. Some changes to IAS 7 are also proposed.

⁴⁶ The International Accounting Standards Board has initiated a programme to review the *IFRS for SMEs Standard* and in particular to consider updates for IFRS standards issued since the last update.

by net assets (or equity). However, the standards do not prohibit a horizontal presentation, with assets presented alongside liabilities and net assets (equity).

- 3.6** These standards do not include any guidance on the issues raised in section two of this issue paper. There is no guidance on fund accounting or the presentation of fund or reserve balances. While the international standards do not prohibit additional information and subtotals being included on the face of the financial statements, no guidance is provided. Each preparer currently needs to use their own judgement in determining an appropriate format for each financial statement.

4. National-level guidance⁴⁷

- 4.1** Where jurisdictions follow international standards, the principles established in section three of this issue paper above largely apply in national standards. Three jurisdictions have standards based on international standards (one based on IFRS Standards, one based on the *IFRS for SMEs* Standard and one based on IPSAS). While these jurisdictions may have some modifications for NPOs (such as reduced disclosure requirements) they do not provide additional guidance on all of the issues raised in Section 2. However, the latter two jurisdictions provide additional guidance that addresses these issues in part.
- 4.2** The jurisdiction that uses the *IFRS for SMEs* Standard provides sector specific guidance for NPOs. NPOs are required to use fund accounting in their financial statements. In presenting the financial statements, funds are aggregated into three classes – unrestricted funds, restricted income funds and restricted endowment funds. Restricted income funds are those funds where an NPO receives funds that the donor requires to be used for a particular purpose. Endowment funds are those funds where the capital is to be invested, with an NPO using the interest (either for a specific purpose or for its ongoing activities). The guidance notes that, while some unrestricted funds may be designated for a specific purpose, because this is an internal decision (that can be reversed), the funds remain unrestricted.
- 4.3** In the income statement, columns show the income and expenditure for each class of fund. The three classes of funds are shown in the statement of financial position, with a columnar presentation permitted but not required. Transfers between funds are included in the income statement. Transfers may occur where, for example, a fixed asset is purchased from a restricted fund but is to be used for non-restricted purposes; or where the restriction on a fund expires and the funds become unrestricted.

⁴⁷ Additional information on national guidance of a limited number of jurisdictions can be found in Supplementary Information: International and national financial reporting standards and guidance.

- 4.4** The jurisdiction whose standards are based on IPSAS issues simplified requirements for smaller NPOs. These requirements provide guidance on the difference between restricted and unrestricted funds (referred to as reserves); however, the minimum reporting requirement is that an aggregated figure for reserves is presented in the statement of financial position. The cash flow statement uses the direct method.
- 4.5** Two jurisdictions have developed national standards that are not based on international standards. The first requires net assets with donor restrictions and net assets without donor restrictions to be presented separately. These are equivalent to restricted funds and unrestricted funds. In the income statement, income with donor restrictions is shown separately from income without donor restrictions. Expenditure is shown as a decrease in net assets without donor restrictions; where an NPO satisfies the conditions imposed by the donor, the net assets are reclassified as net assets without donor restrictions.
- 4.6** The second permits, but does not require, the use of fund accounting in presenting the financial statements. A statement of changes in net assets is required. The different classes of net assets to be presented are: endowments; internally restricted net assets; externally restricted net assets (other than endowments); and unrestricted net assets.
- 4.7** This jurisdiction permits the use of two methods of presenting restricted contributions (incoming cash transfers and gifts in-kind). Under the deferral method income is not recognised until the related expense occurs. Under the restricted fund method, restricted contributions for which a corresponding restricted fund is presented should be recognised as revenue of that fund in the current period. Restricted contributions for which no corresponding restricted fund is presented should be recognised in the general fund in accordance with the deferral method. Accounts preparers must select one method and apply it to all contributions.

5. Alternative financial reporting treatments

- 5.1** All of the alternatives take the minimum requirements of international standards as the starting point. They permit flexibility in the presentation of the financial statements (for example, whether a vertical presentation or horizontal presentation is adopted for the balance sheet). This flexibility is retained in all the alternatives; no prescribed format is proposed. More guidance is proposed in all of the alternatives for NPOs regarding the presentation of net assets (or equity). The presentation approach chosen will depend, at least in part, on how restricted contributions are recognised. The recognition alternatives are discussed in issue paper 3 on non-exchange revenue.

- 5.2** Some jurisdictions permit the use of either the deferral method or the fund accounting method for presenting restricted contributions. Some jurisdictions also have additional requirements to the international standards. For example, some jurisdictions require or permit NPOs to prepare the income statement (statement of financial performance) on a columnar basis, with a column for each type of fund or reserve. These have informed the development of the alternative approaches.
- 5.3** All of the alternatives include disclosure of the entity's policy for the management of reserves on the basis that this could improve transparency
- 5.4** **Alternative 1** is to retain the requirements in the international standards (IFRS Standards, the *IFRS for SMEs* Standard and IPSAS) unchanged and provide supplementary guidance. This guidance could include how additional information would be included in the financial statements when this is relevant for their stakeholders. This could involve disclosures on restricted funds.
- 5.5** **Alternative 2** is built on the *IFRS for SMEs* Standard and draws on guidance from national standards, specifically the use of fund accounting. The use of fund accounting would require, as a minimum, that income is split between restricted and unrestricted income on the face of the income statement. It could also result in additional disclosure on the face of the statement of financial position or in the notes to the financial statements.
- 5.6** **Alternative 3** builds on alternative 2 and adds a new requirement to provide supplementary donor or project statements for material funds or projects. This supplementary information could be part of the financial statements or form part of the notes to the accounts and could be on a cash or accrual basis. This goes beyond existing requirements globally and has the potential to meet the reporting needs of major donors.
- 5.7** The general needs of stakeholders underpin the work of international standard setters in the private and public sectors. The information provided in the financial statements should meet the general information needs of NPO stakeholders, which may differ to the needs of private and public sector stakeholders.

| | Description | Advantages | Disadvantages |
|---|--|---|--|
| <p>Alternative 1</p> <p>Use existing international standards (IFRS Standards, the <i>IFRS for SMEs</i> Standard or IPSAS) with additional NPO-specific guidance on the provision of additional information to meet stakeholder needs.</p> | <ul style="list-style-type: none"> Additional NPO-specific guidance and examples on optional extensions to the presentation requirements, including presentation of restricted funds, use of fund accounting and use of supplementary fund/project statements. Recommend the disclosure of policies regarding the management of reserves. | <p>Technical</p> <ul style="list-style-type: none"> Retains existing presentation of financial statements. <p>Practical</p> <ul style="list-style-type: none"> Specific guidance to assist NPOs in their potentially complex arrangements and to address materiality and cost/benefit. <p>Stakeholder</p> <ul style="list-style-type: none"> Allows NPOs to use only those options that are relevant to their stakeholders. Transparency of earmarked reserves where recommendations are adopted. | <p>Practical</p> <ul style="list-style-type: none"> NPOs may lack the information or expertise required to determine which options are required to meet the needs of their stakeholders. <p>Stakeholder</p> <ul style="list-style-type: none"> Less consistency in financial reporting as different NPOs will present varying levels of detail in the financial statements. May not meet the reporting needs of major donors. |
| <p>Alternative 2</p> <p>Use the <i>IFRS for SMEs</i> Standard and require NPOs to use fund accounting and disclosure of reserves policy in the preparation of the financial statements, with guidance on additional information to meet stakeholder needs.</p> | <ul style="list-style-type: none"> Requirement to report restricted funds separately from unrestricted funds as a minimum. Requirement to use fund accounting for the income statement and for fund/reserve balances. Require the disclosure of policies regarding the management of reserves. Additional NPO-specific guidance on extending fund accounting to other statements and additional funds/reserves if relevant. Additional NPO-specific guidance on the use of supplementary fund/project statements if relevant. | <p>Technical</p> <ul style="list-style-type: none"> Accounting for each fund separately may lead to improvements in financial management. <p>Practical</p> <ul style="list-style-type: none"> Specific guidance to assist NPOs in their potentially complex arrangements and to address materiality and cost/benefit. <p>Stakeholder</p> <ul style="list-style-type: none"> Presentation of restricted funds separately from unrestricted funds may increase transparency of available funds. Transparency on earmarked reserves. Improved consistency of presentation. | <p>Practical</p> <ul style="list-style-type: none"> Additional records may be needed. <p>Stakeholder</p> <ul style="list-style-type: none"> May not meet the reporting needs of major donors. <p>Cost/benefit</p> <ul style="list-style-type: none"> Cost of introducing fund accounting may exceed the benefits for smaller NPOs, as a consequence of additional analysis. The cost of preparing and auditing financial statements may increase. |

| | Description | Advantages | Disadvantages |
|---|--|---|--|
| <p>Alternative 3 Use the <i>IFRS for SMEs</i> Standard and require NPOs to use fund accounting in the preparation of the financial statements, disclosure of reserves policy and in addition prepare supplementary fund/project statements for material funds/projects.</p> | <ul style="list-style-type: none"> Requirement to report restricted funds separately from unrestricted funds as a minimum. Requirement to use fund accounting for the income statement and for fund/reserve balances. Requirement to disclose reserves policy. Requirement to prepare supplementary fund/project statements for material funds/projects. Additional NPO-specific guidance on extending fund accounting to other statements and additional funds/reserves if relevant. | <p>Technical</p> <ul style="list-style-type: none"> Accounting for each fund separately may lead to improvements in financial management. <p>Practical</p> <ul style="list-style-type: none"> Specific guidance to assist NPOs in their potentially complex arrangements and to address materiality and cost/benefit. <p>Stakeholder</p> <ul style="list-style-type: none"> Presentation of restricted funds separately from unrestricted funds will increase transparency of available funds. Improved consistency of presentation. Greater transparency over material funds/projects. <p>Cost/benefit</p> <ul style="list-style-type: none"> Presentation of supplementary fund/project statements may reduce the need for special purpose financial reports. | <p>Practical</p> <ul style="list-style-type: none"> May be difficult to agree a single format that will be granular enough to meet the needs of all large donors. Additional records may be needed. <p>Stakeholder</p> <ul style="list-style-type: none"> Increased length and complexity of the financial statements, and the presentation of different perspectives in the core statements and the supplementary statements, may be confusing for some stakeholders, making the financial statements less relevant. <p>Cost/benefit</p> <ul style="list-style-type: none"> Cost of introducing fund accounting and supplementary statements may exceed the benefits. The cost of preparing and auditing financial statements may increase. |



Specific Matters for Comment 7

- 7.a** Do you agree with the description of issue 7 Financial Statement Presentation? If not, why not?
- 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.
- 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.
- 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.
- 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.

Issue 8: Classification of expenses – function or nature?

1. Description of the issue

- 1.1 To maintain trust, information about an NPO's expenses is particularly important.** NPOs may be expected to have higher levels of transparency than similar-sized private companies in order to be accountable to donors and maintain public trust. Stakeholders will need information about activities and to show how an NPO's objectives are being met (leading to continued financial support for that NPO, amongst other things). Expense information supports stewardship, transparency and accountability for an NPO's activities.
- 1.2 Providing multiple analyses of expenses information creates a burden for NPOs.** NPOs may face a range of requirements for the categorisation of expenses depending on the jurisdiction in which they report and the demand from large funders. These requirements may come from a variety of sources, accounting standards/guidance, regulators, tax authorities and donors.
- 1.3 Stakeholders may not all be interested in the same information.** Some users of the financial statements may be interested in the resources utilised for particular programmes or activities (ie analysis of expenses by function) while others may be more interested in the different types of expense required to deliver an activity, such as staff costs, materials, property costs etc. (ie an analysis of expenses by nature).
- 1.4 Accounting requirements within individual jurisdictions may differ to the needs of resource provider and/or regulators.** Jurisdictions may already have accounting requirements that result in set parameters around how information must be presented. These requirements may either differ from or not address the needs of resource providers as well as regulators, which could lead to additional or multiple reporting requirements.
- 1.5 Comparability between similar NPOs could be useful to the users of NPO financial statements,** particularly for donors, other funders and regulators, to assess the impact each organisation has achieved from resources given. An inconsistent approach will impact comparisons about the use of resources between organisations. However, there may be limitations to comparability due to other factors such as the business model and profile of incoming resources. Information could also be provided by appropriate narrative reporting.
- 1.6 Users of the financial statements may have an interest in the significance of support costs in comparison to the total expenses of an NPO.** This may be particularly so for understanding those expenses that form part of

an NPO's overheads/running costs and those that are used to directly fund the delivery of an NPO's objectives. Support services including the finance function, IT, human resources, legal and governance are a necessary part of operating an NPO. Similarly, users may also be interested in distinguishing the expenses incurred in generating funds from those incurred in delivering programmes or activities to beneficiaries, and the relationship between their donation and the cause to which they donated.

- 1.7 Donors, grantors and regulators can focus on and benefit from a functional analysis of expenses and the ratios which are developed from it.** Such an analysis can support both stewardship and accountability. Problems arise when this might not be sufficient to provide the level of detail needed to fully understand spend on individual programs.

2. Financial reporting challenges

- 2.1 It may be challenging to determine the most appropriate disclosures for inclusion in a single set of Guidance for NPOs.** NPOs need to reflect their expenses in a way that provides a reliable and faithful representation but in a way that also takes account of the cost/benefit of alternative presentations. Broadly the two options for classifying costs are by function (the main areas of an NPO's activities) or by nature (staff costs, property costs, depreciation etc).
- 2.2 Analysis of expenses by function may not aid comparability by stakeholders.** While enabling each NPO to take an approach that best enables it to report on its activities, a functional analysis is likely to vary considerably between NPOs because of differing business models, differing programmes and bundling of activities. If a functional presentation is adopted, an NPO could disclose key amounts by nature too.
- 2.3 Allocating costs to functions may involve considerable judgement.** A functional analysis of expenses that supports the identification of activities can provide more relevant information to users and particularly donors than the classification of expenses by nature. In order to do this, NPOs need to allocate their overheads/running costs to their activities. Such judgements may not be transparent and therefore may erode donors' confidence in the information provided. Any lack of confidence in the expenses analysis may flow into their reading of complementary non-financial reporting including the calculation of ratios.
- 2.4 Analysis of expenses by nature might be more useful to support reporting for regulatory purposes** or to identify accounting transactions such as depreciation. International standards recognise that a nature of expense analysis is more useful for predicting future cash flows. It may also be useful for NPOs in their decision making as it provides financial information about its inputs, over which it is likely to have control. As with a functional

analysis its usefulness will depend on the business model and has limitations as the analysis does not tell you what the inputs delivered.

- 2.5 Analysis by nature and function may not be readily produced from an NPO's accounting system and result in additional costs.** Accounting systems that normally classify costs by nature, may lack the functionality to assign specific costs to both an account (for classification by nature) and an additional element to denote activity. If analysis of expenses is carried out by both nature and function, this will require financial systems to provide information which is detailed and multi-layered. Smaller and particularly the smallest NPOs may not have systems to be able to produce such information without significant additional costs.

3. Relevant international guidance

- 3.1** IFRS Standards, the *IFRS for SMEs* Standard and IPSAS all include specific provisions on the classification of expenses.
- 3.2** IAS 1 *Presentation of Financial Statements* and IPSAS 1 *Presentation of Financial Statements* require a similar classification to the *IFRS for SMEs* Standard. They require that an entity presents, either on the face of the statement of financial performance or in the notes, an analysis of expenses using a classification based on either the nature of expenses or their function within the entity, whichever provides information that is reliable and more relevant.
- 3.3** Both IAS 1 and IPSAS 1 specify that where an analysis by function is presented that the entity is also required to disclose additional information on the nature of expenses, including depreciation and amortisation expense and employee benefits expense. IAS 1 and IPSAS 1 note that both forms are useful but because information on the nature of expenses is useful in predicting future cash flows, additional disclosure is required when the function of expense classification is used.
- 3.4** The *IFRS for SMEs* Standard requires that an entity analyses expenses using a classification based on either the nature of expenses or the function of expenses, whichever provides information that is reliable and more relevant:
- **Analysis of nature expense** – the *IFRS for SMEs* Standard provides examples of this classification of expense ie depreciation, purchases of materials, transport costs, employee benefits and advertising costs. It explains that these costs are not allocated across the functions of the entity.
 - **Analysis by function of expense** – this classification requires expenses to be aggregated according to their function as part of cost of sales or, for example, the costs of distribution or administrative activities. In addition, other sections may require disclosure of certain costs by nature.

- 3.5** The standards are intended to provide users with information on performance, and the IPSAS particularly notes that the disclosures allows users to identify resources allocated to support the major activities of the entity and enhance transparency to enable an entity to discharge its accountability decisions.
- 3.6** The IASB has recently consulted (ED/2019/7) on amendments to IAS 1, which will require entities to present in the operating category of the statement of profit or loss an analysis of expenses using a classification based on either the nature of expense method or the function of expense method. Where the functional analysis of expenses is chosen, an analysis by nature is also proposed in the notes to the accounts. This goes further than the current options about where this information is best presented in the financial statements. The analysis provided will need to be the one which provides the most useful information. The Exposure Draft also prohibits entities from using a mixed approach to presenting the analysis of expenses on the Statement of Financial Performance.

4. National-level guidance⁴⁸

- 4.1** There are differences both within and between jurisdictions that have NPO guidance as to how expenses are required to be analysed.
- 4.2** A number of jurisdictions have standards or guidance that are consistent with international accounting standards and allow entities to choose between classification based on either the function of expense or nature of expense methods.
- 4.3** However, there are jurisdictions that have taken alternative approaches, but are still reflective of the international guidance. For example, in one jurisdiction, separate provisions in the form of multiple Statements of Recommended Practice (the SORPs) specify the requirements for different types of NPOs. The SORPs direct the analysis of expenses to be used, with separate analyses for different types of NPO, to reflect their specific reporting needs.
- 4.4** In another jurisdiction NPOs are required to provide functional expenses grouped by program or support as well as a nature of expense categorisation (eg payroll, rent, etc). These can be made on the face of the statement of activities (statement of financial performance), in a disclosure, or in a separate financial statement. This approach was adopted to improve the understanding of an organisation's service efforts and to understand inputs, which most organisations were using to track expenses.

⁴⁸ Additional information on national guidance of a limited number of jurisdictions can be found in Supplementary Information: International and national financial reporting standards and guidance.

4.5 One national model (under its simplified approach to accrual accounting for not for profit entities) includes a hybrid approach to the classification of expenses. It requires as a minimum, the following aggregated categories to be reported separately:

- expenses related to public fundraising
- volunteer and employee related costs
- costs related to providing goods or services, and
- grants and donations made.

These categories mix both the nature of expenses and the function of expense analyses. This model also allows disaggregation of the abovementioned categories or new categories to be added in the statement of financial performance, when such presentation will enhance users' understanding of the entity's financial performance. The guidance suggests a list of possible disaggregated or additional classes (these classes are based on a nature of expenses analysis).

5. Alternative reporting approaches

5.1 The choice between the function of expense method and the nature of expense method depends on historical, sectoral and regulatory factors and the nature of an NPO. Each method of presentation has benefits for different types of entities. Both methods provide an indication of those costs that might vary, directly or indirectly, with the level of activity of an NPO.

5.2 **Alternative 1** follows IFRS Standards, the *IFRS for SMEs* Standard and IPSAS, allowing each entity to decide how best to present its expenses based on either their nature or their function within an NPO, whichever provides information that is reliable and more relevant. If a functional analysis is chosen, then a nature of expenses analysis must also be disclosed. The presentation chosen must be used on the face of the Statement of Financial Performance.

5.3 **Alternative 2** would remove the choice of primary analysis and require either a by nature or functional analysis of expenses on the face of the Statement of Financial Performance. Whichever analysis is mandated, the other would be permitted to be included in the notes to the financial statements. This approach would limit the choice in international guidance.

5.4 **Alternative 3** would require both methods of analysis to be produced, but a choice as to which method is used for the primary statement. This alternative would form new international guidance as it departs from international accounting standards. While this approach would make consistent the requirements on NPOs, smaller NPOs may need exemptions.

- 5.5 Alternative 4** proposes to combine elements of the nature and function analyses to produce a single analysis. This approach follows the approach used by a national guidance and could be appropriate for less complex entities. This single analysis would intend to meet the needs of all stakeholders.
- 5.6** The alternatives assume that whichever classification of expenses is used each class would be disaggregated into material classes of expenses that are useful to the users of the financial statements. It might be the case that Guidance issued would need to prescribe a minimum classification level. For example, a function of expense analysis might prescribe an analysis of major classes of programme services/activities and mandate the inclusion of expenses on fundraising. A nature of expense analysis could include the following:
- employee expenses/benefits
 - transport expenses
 - depreciation and amortisation expenses
 - premises costs including lease and rental expense, and
 - interest expense.
- 5.7** The Guidance will provide information on the allocation of support services including the method of allocation to support the use of a functional analysis of expenses. The Guidance could also set out the information needed about how programme/activity information has been aggregated, as it is not expected that each programme or activity is individually provided.

| | Description | Advantages | Disadvantages |
|--|---|--|--|
| <p>Alternative 1</p> <p>Allow analysis by function or nature of expense.</p> | <ul style="list-style-type: none"> Require NPOs to present an analysis of expenses using a classification based on either the nature of expenses or the function of expenses whichever provides information that is reliable and more relevant. Guidance could require that the analysis chose is presented on the face of the financial statements. | <p>Technical</p> <ul style="list-style-type: none"> Consistent with IFRS Standards, the <i>IFRSs for SMEs</i> Standard and IPSAS. <p>Practicality</p> <ul style="list-style-type: none"> Provides flexibility for NPOs to choose the more appropriate method and easy to implement. <p>Stakeholder information</p> <ul style="list-style-type: none"> Allows the preparation of information about an NPO's overheads/running costs. Allows NPOs to produce an analysis that is most useful to the users of their financial statements. If the analysis is presented on the face of the financial statements, it may help users access and understand the information. <p>Cost/benefit</p> <ul style="list-style-type: none"> The choice enables the most cost-effective basis. | <p>Stakeholder information</p> <ul style="list-style-type: none"> Permitting choice does not enable comparability between NPOs to assess how well an NPO has utilised the resources donated and given to it. <p>Cost/benefit</p> <ul style="list-style-type: none"> The most informative is not always the easiest analysis to produce. |
| <p>Alternative 2</p> <p>Require analysis of expenses by nature or require analysis of expenses by function.</p> | <ul style="list-style-type: none"> Require NPOs to provide only the analysis of expenses by nature on the face of the Statement of Financial Performance or alternatively only an analysis of expenses by function on the face of the Statement of Financial Performance. Additional analysis could be provided but there is no choice over the primary analysis. | <p>Technical</p> <ul style="list-style-type: none"> Type of analysis allowed by IFRS Standards, the <i>IFRSs for SMEs</i> Standard and IPSAS. <p>Practical</p> <ul style="list-style-type: none"> If analysis of expenses this may be easier to produce, as most likely to match internal reporting requirements. <p>Stakeholder information</p> <ul style="list-style-type: none"> If analysis of expenses by nature this will enable comparability with other NPOs and other organisations. <p>Cost/benefit</p> <ul style="list-style-type: none"> Easier to produce than functional analysis. | <p>Technical</p> <ul style="list-style-type: none"> May weaken international standards as removes the requirement for the most relevant presentation. <p>Practical</p> <ul style="list-style-type: none"> Could be resource demanding for NPOs (particularly smaller NPOs). <p>Stakeholder information</p> <ul style="list-style-type: none"> If nature of spend analysis it will not provide information on the cost of activities or an NPO's running costs, which may be more useful to users such as donors. |

| | Description | Advantages | Disadvantages |
|---|---|--|---|
| <p>Alternative 3</p> <p>Require analysis on both a function of expense and nature of expense analysis.</p> | <ul style="list-style-type: none"> Require classification based both on the nature of expenses and the function of expenses in the performance statement or in the notes to the accounts. The analysis which provides information that is reliable and more relevant should be included on the face of the performance statement with the alternative being included in the notes (to reduce excessive detail being included in the financial statements). | <p>Technical</p> <ul style="list-style-type: none"> Types of analysis allowed by IFRS Standards, the <i>IFRSs for SMEs</i> Standard and IPSAS. <p>Stakeholder information</p> <ul style="list-style-type: none"> Provides the benefits of both classifications and is more likely to meet the needs of most users. Allows the preparation of information about an NPO's overheads/running costs. Enable comparability with other NPOs and other organisations. Possibility of functional comparisons. | <p>Technical</p> <ul style="list-style-type: none"> Goes beyond the requirements of current international standards. <p>Stakeholder information</p> <ul style="list-style-type: none"> Difficulty of determining and/or defining a common functional analysis to aid comparability. Specification of functions risks the functional analysis not being useful for some groups of NPOs' and their users. <p>Cost/benefit</p> <ul style="list-style-type: none"> The cost may outweigh the benefits particularly for smaller NPOs. |
| <p>Alternative 4</p> <p>Hybrid expense analysis, which sets out minimum reporting categories.</p> | <ul style="list-style-type: none"> Require classification to minimum, defined categories, which are to be reported separately on the face of the Statement of Financial Performance. These categories mix both the nature of expenses and the function of expense analyses and could include expenses related to public fundraising, volunteer and employee related costs. | <p>Practical</p> <ul style="list-style-type: none"> Only one analysis required which would simplify reporting. Stakeholder information Might meet the needs of stakeholder for less complex entities. <p>Cost/benefit</p> <ul style="list-style-type: none"> Analysis could reduce additional reporting if it can be reflected in finance systems. | <p>Technical</p> <ul style="list-style-type: none"> Not allowed by IFRS Standards, the <i>IFRS for SMEs</i> Standard or IPSAS. <p>Stakeholder information</p> <ul style="list-style-type: none"> Difficulty in defining internationally applicable expense categories to meet the needs of all stakeholders. |



Specific Matters for Comment 8

- 8.a** Do you agree with the description of issue 8: Classification of expenses? If not, why not?
- 8.b** Do you agree that the list of alternative approaches that should be considered for issue 8 is complete? If not, please describe your additional proposed alternatives, and explain why they should be considered.
- 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.
- 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.
- 8.e** Do you think that the alternatives for issue 8 provide the right balance between information presented on the face of the performance statements or in the notes?
- 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?
- 8.g** Are there any practical questions that arise in implementing your preferred option for issue 8?

Issue 9: Fundraising costs

1. Description of the issue

- 1.1 Information about fundraising costs is important** to many users of NPO financial statements. Users may compare fundraising costs with the income generated, or with programme delivery costs, and use this information to assess efficiency. Ratios of fundraising costs to income or other costs may, however, be misleading.
- 1.2 Fundraising activities and therefore costs are not easy to define.** Some fundraising activities may seem relatively obvious, such as a fundraising event or a shop to sell donated items. But many other activities are also important to income generation, such as business development (eg writing grant proposals), general brand awareness (eg having a website), but they may be less easily identified as fundraising.
- 1.3 Activities with the primary objective of raising funds may serve additional purposes.** For example, a fundraising event or printed brochure may also be used to share a mission-related awareness message, recruit volunteers, or identify potential service recipients. In this instance, a fundraising activity that fails to generate net income may still be considered worthwhile if the other objectives are met.
- 1.4 The way direct costs are allocated to 'fundraising' can be subjective.** Fundraising activities may involve the effort of multiple staff to varying degrees, or the use of organisation assets. The method used to allocate direct costs (such as staff time, running costs for a shared vehicle, or depreciation) to different projects or activities can vary widely from one organisation to the next. This may lead to a lack of comparability amongst similar NPOs.
- 1.5 The true cost of fundraising activities may include an element of indirect costs.** The methods used to allocate indirect costs to activities can vary widely between organisations. NPOs may have incentives to maximise the amount of overheads allocated to service delivery activities compared to management or fundraising.
- 1.6 The costs and complexities of allocating indirect costs may outweigh the benefits.** It may be difficult to allocate overheads shared between fundraising activities and other activities. Although there are benefits in seeing the full cost of fundraising activities, the costs of doing so and practical difficulties may render this not worthwhile.

- 1.7 Fundraising costs are generally incurred before the corresponding income is generated.** This timing difference means that the costs and income recognised in any given accounting period may not be comparable.

2. Financial reporting challenges

- 2.1 The identification of costs of fundraising activities may not align completely with cost classification by function,** which is a method permitted in international standards. Fundraising costs may not comfortably belong to functional classification categories (production, administration, finance, selling, distribution, research and development) or natural classification categories (labour, materials and expenses). This may differ depending on the nature and size of the entity. For more information on classification of expenses see issue paper 8.
- 2.2 Fundraising costs may not be readily identified from an NPO's accounting system.** The costs associated with fundraising activities may be found across various accounts within accounting systems that classify costs by nature, such as salaries, medical costs, internet, website, printing, travel, professional fees, depreciation etc. Accounting systems may lack the functionality for assigning specific costs to both an account (for classification by nature) and an additional element to denote activity.
- 2.3 There may be benefits in standardising the definition of fundraising costs.** The most significant consideration would be how to define the fundraising costs in a way that can be applied across NPOs. The Guidance could address the presentation of direct fundraising costs, the treatment of business development costs, the basis of allocation of overheads and disclosure requirements.
- 2.4 Fundraising costs should be recognised using the same principles as any other expenditure,** ie at the point the good or service is received. This may lead to timing differences between fundraising costs being incurred and the recognition of the resulting income.
- 2.5 Fundraising costs should be presented gross,** in accordance with the 'no netting off' principle adopted in international accounting standards, consistent with all other expenditure. However, in some instances this may not be practical.
- 2.6 Additional disclosures could be considered to assist users** understand fundraising activities, with standardised information about fundraising costs and information about timing differences. Such detailed requirements would go beyond the general presentation and disclosure requirements of current accounting standards. These disclosures could form part of the notes to the accounts or be a part of narrative reporting. Narrative reporting in most jurisdictions has lower levels of audit scrutiny.

- 2.7** **The usefulness of ratios could be considered further** if a framework is developed for narrative reporting (see issue paper 10 for more information on narrative reporting).

3. Current international guidance

- 3.1** Neither IFRS Standards, nor the *IFRS for SMEs* Standard nor IPSAS specifically address this issue.

Presentation of expenses by nature or function

- 3.2** IAS 1 *Presentation of Financial Statements* and IPSAS 1 *Presentation of Financial Statements* require an entity to present an analysis of expenses classified either by nature or function within the entity, whichever provides information that is reliable and more relevant. This information may be presented either on the face of the statement of financial performance or in the notes. Function is not defined in either standard.
- 3.3** The *IFRS for SMEs* Standard requires an entity to present an analysis of expenses classified either by nature or function:
- Analysis by nature of expense – examples are provided eg depreciation, purchases of materials, transport costs, employee benefits and advertising costs. It explains that these costs are not allocated across the functions of the entity.
 - Analysis by function of expense – this categorisation requires expenses to be aggregated according to their function as part of cost of sales or, for example, the costs of distribution or administrative activities.

Segmental reporting

- 3.4** Fundraising could be a segment as defined by international accounting standards but using a segment for fundraising would require other parts of the business to be reported in the same way and require the disclosures on performance, assets and liabilities.
- 3.5** Both IFRS 8 *Operating Segments* and IPSAS 18 *Segment Reporting* focus on the disclosure of operating segments of an entity and on the services and geographical areas in which an entity operates. The standards are intended to provide users with more information on performance and assets and liabilities.
- 3.6** IPSAS 18 particularly notes that the disclosures allow users to identify resources allocated to support the major activities of the entity and enhance transparency to enable an entity to discharge its accountability decisions.

- 3.7** IFRS 8 requires a focus on the revenues of an entity and identification of segments is based on internal reports that are regularly reviewed by the entity's chief operating decision maker. The IPSAS is similar but the decision-making requirements for segmental information are more focussed on activities (as opposed to revenues) and therefore may provide a more useful reporting structure for NPOs.
- 3.8** There is no requirement for segment reporting in the *IFRS for SMEs* Standard.

4. National-level guidance⁴⁹

- 4.1** While there is no specific international guidance a few jurisdictions have additional guidance on the reporting of fundraising costs. This national guidance does not provide a single view of the definition of the cost of fundraising.
- 4.2** One jurisdiction requires all expenditure on fundraising to be identified and provides a list of activities as examples. These examples for registered charities in the jurisdiction include; seeking grants and donations, operating membership schemes and social lotteries, staging events (including the performance fees, licence fees and other related costs), contracting with agents to raise funds on behalf of the charity, operating charity shops selling donated and/or bought-in goods, operating a trading company undertaking non-charitable trading activities, advertising, marketing, and direct mail materials. It also requires that costs and income are shown gross.
- 4.3** One jurisdiction has guidance for smaller entities that provides for an analysis of expenses that draws on expenses by nature and function. Expenses for public fundraising are required to be disclosed as part of this guidance.
- 4.4** Another jurisdiction provides guidance on allocating costs to fundraising from certain joint activities. Typically, advertising and other business development costs are not included in Fundraising Costs but would be included in other functional activities such as 'Management and General Activities'. It requires the cost of fundraising to be presented on a gross basis except for some costs associated with special events such as fundraising galas. The guidance includes what it describes as a programmatic element.
- 4.5** Another jurisdiction has guidance that addresses the timing of the recognition of fundraising costs.

⁴⁹ Additional information on national guidance of a limited number of jurisdictions can be found in Supplementary Information: International and national financial reporting standards and guidance.

5. Alternative financial reporting treatments

- 5.1** IFRS Standards, the *IFRS for SMEs* Standard and IPSAS all allow expenses to be analysed by nature or function in the financial statements.⁵⁰ They all require expenses to be presented on a gross basis.
- 5.2** **Alternative 1** allows organisations to use any of the international frameworks as they have similar requirements. This would allow NPOs to continue to develop their own policies on the treatment of such costs, with additional guidance to support NPOs with the identification of fundraising costs and could provide recommendations for financial reporting. This might include fundraising costs being reported as a function as part of a functional analysis.
- 5.3** **Alternative 2** requires an entity to follow IFRS Standards, the *IFRS for SMEs* Standard or IPSAS with additional guidance that requires (where fundraising costs are included in the financial statements), an NPO to disclose its accounting policy for fundraising costs. This would include which types of costs form part of this activity and the approach to allocation of overhead.
- 5.4** **Alternative 3** would rely on new NPO-specific guidance being developed. This would require fundraising costs to be disclosed along with the accounting policy. The Guidance developed for this alternative could provide the basis for a standard definition along with cost allocation methodologies, and might usefully include a list of fundraising activities to assist NPOs, such as:
- Direct staff costs for the fundraising activity.
 - Materials required for the fundraising activity including for example, printing and mailing costs, performance fees, licence fees and other related costs.
 - IT costs.
 - Agency fees and costs.
 - Marketing and advertising costs.
 - Planning and research costs.
 - Costs of any outsourcing work or consultancy.
 - Allocation of indirect costs including general overheads, business development and administration.
- 5.5** IFRS Standards and IPSAS include segmental reporting requirements in their analysis of expenses. Segmental reporting has not been included in the alternatives as it may be too onerous for smaller organisations.
- 5.6** Consistent with the international frameworks, none of the alternative approaches permit costs to be netted from the related income. Pragmatically, there may be a limited number of examples where exemptions from this might be permitted.

⁵⁰ The Exposure Draft of the IASB's Primary Financial Statement's project introduced a new 'financial activities' category with the income statement, which might be relevant to this too.

| | Description | Advantages | Disadvantages |
|---|--|--|---|
| <p>Alternative 1</p> <p>Follow existing international guidance on the recognition, presentation and disclosure of expenses with NPOs deciding whether the resulting information is reliable and relevant to its users of the financial statements. Additional guidance will support NPOs.</p> | <ul style="list-style-type: none"> Expense recognition, measurement and presentation to follow relevant international standards. Fundraising expenses to be presented (and disclosed) in accordance with an NPO's decisions on whether this information is reliable and relevant to the users of the financial statements. The costs must not be netted off from income received from fundraising. Additional guidance to provide NPO-specific examples and could recommend reporting to stakeholders. | <p>Technical</p> <ul style="list-style-type: none"> Follow IFRS Standards, the <i>IFRS for SMEs</i> Standard and IPSAS. <p>Practical</p> <ul style="list-style-type: none"> Easy to implement. <p>Cost/benefit</p> <ul style="list-style-type: none"> Cost neutral. | <p>Stakeholder information</p> <ul style="list-style-type: none"> This could lead to inconsistent approaches across similar NPOs. This may mean that stakeholders are not able to assess an NPO's performance in relation to the cost of fundraising. |
| <p>Alternative 2</p> <p>Follow existing international guidance on the recognition, presentation and disclosure of expenses with NPOs deciding whether the resulting information is reliable and relevant to its users. Require the disclosure of the accounting policy on fundraising costs only if such costs are disclosed in the financial statements. Additional guidance will support NPOs.</p> | <ul style="list-style-type: none"> Expense recognition, measurement and presentation to follow relevant international standards. Fundraising expenses to be presented (and disclosed) in accordance with an NPO's decisions on whether this information is reliable and relevant to the users of the financial statements. The costs must not be netted off from income received for fundraising. Require disclosure of the accounting policy on fundraising costs only if reported separately in the financial statements, ie under either an analysis by function of expense or as a part of a segmental analysis. Additional guidance to provide NPO-specific examples and could recommend reporting to stakeholders. | <p>Technical</p> <ul style="list-style-type: none"> Allowed by IFRS Standards, the <i>IFRS for SMEs</i> Standard and IPSAS. <p>Practical</p> <ul style="list-style-type: none"> Easy to implement. <p>Stakeholder information</p> <ul style="list-style-type: none"> Increased transparency could provide users with a clearer understanding of the costs of fundraising. Improved understanding of the costs to raise a unit of funding. | <p>Stakeholder information</p> <ul style="list-style-type: none"> This could lead to inconsistent approaches across similar NPOs. <p>Cost/benefit</p> <ul style="list-style-type: none"> May result in additional disclosures to prepare and be subject to audit. Might create a disincentive to disclose costs of fundraising if additional disclosures are required. |

| | Description | Advantages | Disadvantages |
|--|---|--|--|
| <p>Alternative 3</p> <p>Develop new NPO-specific guidance that requires disclosure of the amount and accounting policy for fundraising costs.</p> | <ul style="list-style-type: none"> Expense recognition, measurement and presentation to follow relevant international standards. Require reporting of fundraising costs, using pragmatic guidance on the presentation and disclosure of expenses which requires NPOs to: <ul style="list-style-type: none"> report its accounting policy for the cost of fundraising disclose fundraising costs in a note to the accounts. The costs must not be netted off from income received for fundraising. | <p>Technical</p> <ul style="list-style-type: none"> Allowed by IFRS Standards, the <i>IFRS for SMEs</i> Standard and IPSAS. <p>Practical</p> <ul style="list-style-type: none"> Flexibility to define the costs of fundraising within the principles established by the guidance. <p>Stakeholder information</p> <ul style="list-style-type: none"> Supports a more consistent approach to define the costs of fundraising. Increased transparency enables users to have a clearer understanding of the costs of fundraising. Improved understanding of the costs to raise a unit of funding | <p>Stakeholder information</p> <ul style="list-style-type: none"> Not able to report the costs of fundraising in a way which is most relevant to the organisation. <p>Cost/benefit</p> <ul style="list-style-type: none"> May result in additional disclosures to prepare and be subject to audit. |



Specific Matters for Comment 9

- 9.a** Do you agree with the description of issue 9 – Fundraising costs? If not, why not?
- 9.b** Do you agree that the list of alternative approaches that should be considered for issue 9 is complete? If not, please describe your additional proposed alternatives, and explain why they should be considered.
- 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.
- 9.d** Please identify the alternative approach that you favour for issue 9, and the reasons for your view.
- 9.e** Do you agree that all fundraising costs should be presented gross? If not, please provide example of where this might not apply and the reasons for your view.

Issue 10: Narrative reporting

1. Description of the issue

- 1.1 Financial statements do not tell the whole story.** There has for decades been a recognition that financial statements, while being important, do not meet all the information needs of users and that there is a need for the provision of other information giving details of, for example, an entity's performance and prospects. For example, in 1978 the European Union introduced a requirement that the reporting package of financial information consists of financial statements and the annual report, and that the latter "...must include at least a fair review of the development of the company's business and of its position".
- 1.2 The importance of such other, narrative, information is as relevant, if not more so, for NPOs, in particular for demonstrating accountability and stewardship to stakeholders and civil society.** For many NPOs, the financial statements may not capture some of the most important aspects of an organisation's performance, which can focus more on non-financial issues and measures. Examples of such aspects could include the use and importance of volunteer contributions and the impact of an organisation on the communities and beneficiaries it seeks to serve.
- 1.3 Non-financial reporting can bring greater clarity.** For NPOs there can be a lack of clarity on the reporting of remuneration, governance arrangements and the effectiveness of an NPO with a focus on making maximum use of resources received. As noted in issue paper 9 on Fundraising Costs, this can be addressed through the publication of ratios that are intended to demonstrate the relationship between fundraising and service delivery costs.
- 1.4 Disclosure requirements currently vary across jurisdictions, dependent on local accounting requirements, local regulation and local legislation.** This can make it challenging for stakeholders where an NPO's General Purpose Financial Reports (GPFRs) are used in multiple jurisdictions or where a stakeholder is using GPFRs from similar NPOs that operate in different jurisdictions.

2. Financial reporting challenges

- 2.1 Which framework to use?** Non-financial reporting has become a 'growth industry' in recent years, with the proliferation of multiple frameworks, codes, standards and guidelines on a wide range of reporting issues, many in the broad area of sustainability (also referred to as corporate responsibility, corporate social responsibility (CSR), and environmental, social and governance (ESG) reporting). There is also an increasing focus on reporting on climate-

related issues. An initial challenge would be to determine which of the multiple frameworks, codes, standards and guidelines would be the most appropriate basis on which to develop proposals for narrative reporting by NPOs.

2.2 At which level should non-financial reporting proposals be pitched?

There is also an issue as to the extent to which any proposals for non-financial reporting by NPOs should be pitched at a 'framework' level, articulating broad principles and content elements to be included, rather than any other more specific items and/or measures to be included. For example, the issues of the classification of expenses by function or nature and fundraising costs (Issues Papers 8 and 9 respectively) and, in particular, whether disclosures relating to such costs and their categorisation (including ratio analysis of such costs) could form part of the notes to the financial statements or part of non-financial reporting. It should be noted that disclosures as part of the financial statements are subject to audit, rather than more limited assurance review for the material that accompanies the financial statements.

2.3 There is a challenge in providing information from a management

perspective. Narrative reporting is usually prepared from the perspective of the management of an organisation, hence its description using terms such as "management commentary" (see paragraph 3.1). Narrative reporting provides an opportunity for management to provide to stakeholders its perspective of the organisation's performance, position and progress, including information that is useful to an understanding of:

- a. the nature of the organisation's business
- b. management's objectives and its strategies for meeting those objectives
- c. the organisation's most significant resources, risks and relationships
- d. the results of operations and prospects (including information that both complements and supplements the financial statements, as well as providing forward-looking information)
- e. the key performance measures and indicators that management uses to evaluate the organisation's performance against stated objectives.

2.4 How much flexibility is allowed? The general principles and content elements of narrative reporting could be applicable to all organisations, although the appropriate level of detail in reporting could differ depending on factors such as an organisation's size, complexity and resources. The flexibility of a principles-based approach is relevant to consider in the context of the calls that have been made for NPO narrative reporting to address such matters as the remuneration of key management personnel and related party disclosures.

2.5 There may be a challenge in exercising judgement. A framework approach based on principles demands more judgement from management than a more prescriptive approach and there can be a risk that, faced with interpretative

uncertainty, management will err on the side of caution and disclose larger quantities of data rather than exercising the judgement required to present the information to meet stakeholders' needs. This may generate confusion, rather than transparency if reports become overly complex. Also, requirements in local jurisdictions could add to or be inconsistent with disclosures arising from a framework type approach.

- 2.6 Some aspects of narrative reporting can involve more uncertainty than the information presented in the financial statements.** This is the case, for example, in the provision of forward-looking information, where it could be appropriate for management to explain any material assumptions in the preparation and disclosure of such information. There will also be challenges in the inclusion of non-financial measures and indicators, where management will have to explain how these measures and indicators are defined and calculated. There will also be a challenge in management reporting in a balanced way, dealing even-handedly with both good and bad aspects of the performance, progress and prospects of the organisation.
- 2.7 Non-financial information can be challenging to audit.** Much of the narrative reporting that currently takes place at both international and national level is within an organisation's annual report, but outside the financial statements. As a consequence, such reporting falls outside the scope of a formal opinion by the auditors on the financial statements, although there will often be a requirement on the auditors (for example, as in International Standard on Auditing (ISA) 720 (Revised) *The Auditor's Responsibility Relating to Other Information*) to read such information to identify any material inconsistencies between that other information and (a) the financial statements and (b) the auditors' knowledge obtained in the audit. This is a level of assurance significantly less than that of a formal audit.

3. Current international guidance

- 3.1** IFRS Standards do not address the issue of narrative reporting within the Standards themselves, but the IASB in 2010 issued a non-mandatory Practice Statement *Management Commentary*, which does cover the issue. The IASB is in the process of reviewing and revising the Practice Statement, with an Exposure Draft (ED) scheduled for release during the first half of 2021.
- 3.2** The *IFRS for SMEs* Standard does not specifically include narrative reporting, although the non-mandatory practice statement is available for use.
- 3.3** Likewise, IPSAS do not specifically address this issue within the Standards themselves. The IPSASB has also issued non-mandatory material in the form of Recommended Practice Guidelines (RPGs) to address the issue, as follows:

- RPG 2 *Financial Statement Discussion and Analysis* (2013), which covers some, but not all, the issues covered in the IASB's Practice Statement referred to above, focusing on an explanation of the significant items, transactions and events presented in an entity's financial statements and the factors that influenced them; and
 - RPG 3 *Reporting Service Performance Information* (2015), which focuses more on how an entity should report on its effectiveness, efficiency, inputs, outputs and outcomes, together with its performance indicators and service performance objectives.
- 3.4** Both the IFRS Practice Statement and IPSAS RPGs adopt a framework approach based on principles, giving entities flexibility on how to apply them relevant to their own circumstances, rather than setting out very specific individual recommendations.
- 3.5** Both the IASB and IPSASB have standards on related party disclosures (IAS 24 *Related Party Disclosures* and IPSAS 20 *Related Party Disclosures*) which focus on the disclosure in the notes to the financial statements of remuneration (including salaries and other benefits such as pensions) of key management personnel (in aggregate) and related party disclosures. The *IFRS for SMEs* Standard requires related party disclosures consistent with IAS 24.
- 3.6** Outside of the IASB and IPSASB guidance, one other major relevant development (of many, as noted above) in recent years has been the growth of Integrated Reporting (IR), in particular the International Integrated Reporting Framework developed by the International Integrated Reporting Council (IIRC).
- 3.7** The IIRC Framework provides a non-mandatory, principles-based reference for organisations wishing to adopt Integrated Reporting. The primary purpose of an integrated report is to explain to providers of financial capital (and other stakeholders) how an organisation creates value over time. An integrated report aims to provide insight about the resources and relationships used and affected by an organisation (referred to as capitals in the Framework, covering financial, manufactured, intellectual, human, social relationship, and natural capital). The Framework approach enables an organisation to set out its report in its own way rather than adopt a checklist approach. In February 2020, the IIRC launched a process to revise the Framework.
- 3.8** While developed for the for-profit sector, IR could be relevant for NPOs to demonstrate how they seek to optimize their use of available resources and report on operations to their stakeholders.

4. National-level guidance⁵¹

- 4.1** There are differences between jurisdictions in the requirements and/or guidance for narrative reporting by NPOs. We are unaware of any jurisdiction that has a separate standard or standards governing narrative reporting by NPOs.
- 4.2** One jurisdiction provides guidance on narrative reporting within its overall requirements for accounting and reporting by NPOs. In that jurisdiction, a Statement of Recommended Practice (SORP) sets out not only requirements for the preparation of financial statements, but also the content of the annual report prepared by the management body (the trustees in this instance), including the context for, and a narrative explanation of, the financial information contained in the accounts. There are differential narrative reporting requirements, given the greater degree of accountability to civil society and stewardship reporting required of larger NPOs. Those requirements share much in common with the jurisdictional requirements for narrative reporting by corporate entities, which in turn share much in common with the IASB's *Management Commentary Practice Statement*.
- 4.3** Another jurisdiction has a specific standard that sets out requirements for its Public Benefit Entities (NPOs) in their reporting of service performance information. The standard takes into account the extent to which the recommendations in IPSASB's RPG 3 are appropriate in the jurisdictional context. As with the jurisdiction referred to in paragraph 4.2 above, the standard contains differential reporting requirements. The standard also establishes principles and high-level requirements for the reporting of service performance information rather than specifying detailed reporting requirements.
- 4.4** A number of other jurisdictions, whilst having no general guidance covering narrative reporting by NPOs as part of their annual reports, do have specific requirements to lodge annual information with their relevant regulatory body. However, such annual returns are generally focused on meeting the information needs of a regulatory body, rather than forming part of General Purpose Financial Reporting (GPFR).

5. Alternative financial reporting treatments

- 5.1** Given the importance of narrative reporting in the NPO context, and the fact that there is existing guidance at both international and jurisdictional level, it could be beneficial to incorporate the development of global narrative reporting guidance as part of the IFR4NPO initiative.

⁵¹ Additional information on national guidance of a limited number of jurisdictions can be found in Supplementary Information: International and national financial reporting standards and guidance.

- 5.2 Alternative 1** proposes the continued use of existing guidance relevant in each jurisdiction, would be the default option if feedback from respondents proposes that narrative reporting is not included within the scope of the project. The scope of this project, which is proposed to include narrative and non-financial reporting, is considered in Part 1 to this document. This would mean that individual jurisdictions and/or organizations would continue to develop their own policies and guidance on narrative reporting.
- 5.3 Alternative 2** proposes additional guidance for NPOs consistent with the recommendations of the IASB and IPSASB, but with specific NPO examples consistent with Part 1. In this alternative, applying the principles outlined in the additional guidance could be required for all GPFs.
- 5.4 Alternative 3** proposes to move ahead of current international accounting guidance and move to the International Integrated Reporting Council framework. This could be tailored for NPOs and enable a comprehensive view of an organisation's resources and relationships and how it has used these and plans to use them over time. In tailoring for NPOs, this would focus on the needs of NPO stakeholder groups. This alternative, with its tailored solution arguably goes beyond the proposed way forward in Part 1: Chapter 5. Given the flexibility inherent in the *IIRC Framework* and its standing as an international framework, the case can be made that it is consistent with harnessing international guidance as set out in the proposed way forward.

| | Description | Advantages | Disadvantages |
|--|---|---|--|
| <p>Alternative 1</p> <p>'Do nothing'</p> <p>Leave organisations/ jurisdictions to follow existing guidance on narrative reporting by NPOs.</p> | <ul style="list-style-type: none"> Organisations are left to follow any existing guidance or requirements in their own jurisdictions, or to voluntarily apply any existing international guidance. | <p>Technical</p> <ul style="list-style-type: none"> Meets the requirements/ recommended practice of IFRS and IPSAS. <p>Practical</p> <ul style="list-style-type: none"> No change on the current position so easy to implement. <p>Cost/benefit</p> <ul style="list-style-type: none"> Minimises burdens on NPOs. | <p>Practical</p> <ul style="list-style-type: none"> Missed opportunity to develop global best practice on what 'good' narrative reporting should cover. <p>Stakeholder</p> <ul style="list-style-type: none"> Many jurisdictions have no guidance at all on non-financial reporting, which would remain the case. Inconsistent approaches across similar entities and across jurisdictions. Fails to reflect the importance of, narrative reporting across all sectors and across the world and the transparency that results. |
| <p>Alternative 2</p> <p>Apply existing international guidance on narrative reporting, tailored as appropriate for reporting in the NPO context.</p> | <ul style="list-style-type: none"> Narrative reporting is required to accompany the financial statements based on additional guidance drawing on international guidance on narrative reporting. | <p>Technical</p> <ul style="list-style-type: none"> Meets the requirements/ recommended practice of IFRS and IPSAS. <p>Practical</p> <ul style="list-style-type: none"> Clear framework providing principles for the basis of narrative reporting. <p>Stakeholder</p> <ul style="list-style-type: none"> Better communication with all stakeholders, with improved and fuller understanding by all stakeholders of the performance, position and prospects of NPOs. | <p>Practical</p> <ul style="list-style-type: none"> NPOs may have to apply greater judgement in difficult areas, such as forward-looking information and non-financial measures and indicators. <p>Cost/benefit</p> <ul style="list-style-type: none"> Will result in additional narrative disclosures to prepare. |

| | Description | Advantages | Disadvantages |
|--|--|---|---|
| <p>Alternative 3</p> <p>Apply integrated reporting, following the IIRC Framework, tailored as appropriate for reporting in the NPO context.</p> | <ul style="list-style-type: none"> • NPOs to produce an integrated report in line with the IIRC Framework, providing insight of each of the six capitals. • Would incorporate alternative 2 but go beyond it in the provision of a wider integrated report. • Additional guidance to assist NPOs in applying the framework. | <p>Technical</p> <ul style="list-style-type: none"> • Meets the requirements/ recommended practice of IFRS and IPSAS. • Could put NPOs at the forefront of corporate reporting. <p>Practical</p> <ul style="list-style-type: none"> • IIRC Framework provides a great deal of flexibility in how organizations report, allowing them to develop their reporting over time. • Clear framework providing principles for the basis of narrative reporting. • Provides an opportunity to address/change internal management processes to achieve integrated management. <p>Stakeholder</p> <ul style="list-style-type: none"> • Better communication with all stakeholders, with improved and fuller understanding by all stakeholders of the performance, position and prospects of NPOs. | <p>Practical</p> <ul style="list-style-type: none"> • Will involve NPOs in having to apply greater judgement in determining narrative reporting disclosures in difficult areas, such as forward-looking information and non-financial measures and indicators. • Need to address/change internal management processes (which could also be an advantage). <p>Cost/benefit</p> <ul style="list-style-type: none"> • Could place administrative burdens on NPOs to understand and report on issues/ areas that go beyond GPFR. • Uncertainties about the cost of preparation of an integrated report. |



Specific Matters for Comment 10

- 10.a** Do you agree with the description of issue 10 – Narrative reporting? If not, why not?
- 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.
- 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.
- 10.d** Please identify the alternative treatment that you favour for issue 10, and the reasons for your view.
- 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?



Supplementary information

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1. Project background

1.1 Current financial reporting context

- 1.1.1** International accounting standards have been available for the private sector since the 1970s and the public sector since the early 2000s. They have provided a focal point for global convergence and brought tangible benefits in terms of raising funds and providing decision-useful information.
- 1.1.2** There are no international accounting standards for non-profit organisations, and few countries have their own sector-specific guidance. Financial statements are therefore prepared using standards developed for the private or public sectors, or a mix of both. This can lead to differences in how the same transactions are treated within and between jurisdictions. There have also been issues around the adequacy of narrative reporting.
- 1.1.3** The disparities in reporting can lead to lack of transparency and undermine the relevance and credibility of NPO financial statements. Differences can also mean that there are failures in accountability and the provision of decision useful information. This can lead to a breakdown in trust and issues such as 'double funding' where the costs for the same activity are claimed against multiple grants.
- 1.1.4** NPO funders often use the audited accounts of potential grantees as part of their due diligence processes, but the staff responsible may struggle to find the information they need to make judgements about the organisation's financial health and capability. The wide variety of formats and treatments also makes it harder to make comparisons between grantees. This slows down the grant making process and makes it less reliable.
- 1.1.5** When funders request financial information as part of grant accountability, they often specify their own accounting or reporting requirements, creating further complexity and duplication of work for NPOs.
- 1.1.6** As a result, NPOs currently face a multiplicity of regimes which require financial information to be prepared under different accounting and financial reporting standards, causing considerable time and resources to be spent in a wasteful and inefficient system.
- 1.1.7** These problems have been raised across the world for a number of years and are being exacerbated by the increasing number of organisations operating globally or on a more restricted geographic basis but still internationally across jurisdictional borders. These issues have been reported through academic studies, by standard setters and by members of the NPO community, including donors.

1.1.8 Despite these findings, neither the International Accounting Standards Board (IASB) nor the International Public Sector Accounting Standards Board (IPSASB) has had the resources to develop guidance for NPOs given that developing such standards is not within the remit of either body, coupled with pressures on their respective agendas.

1.2 Project outputs and outcomes

1.2.1 The International Financial Reporting for Non-Profit Organisations (IFR4NPO) project is intended to play a key role in strengthening the accountability of NPOs in every country around the world. The project seeks to enable a better managed, more effective and accountable sector, with greater credibility and trust and lower costs of financial reporting. It also aims to support improvements in NPO accounting practice with the goal of higher quality financial information for internal and external users, stronger internal control, and improved cost recovery.

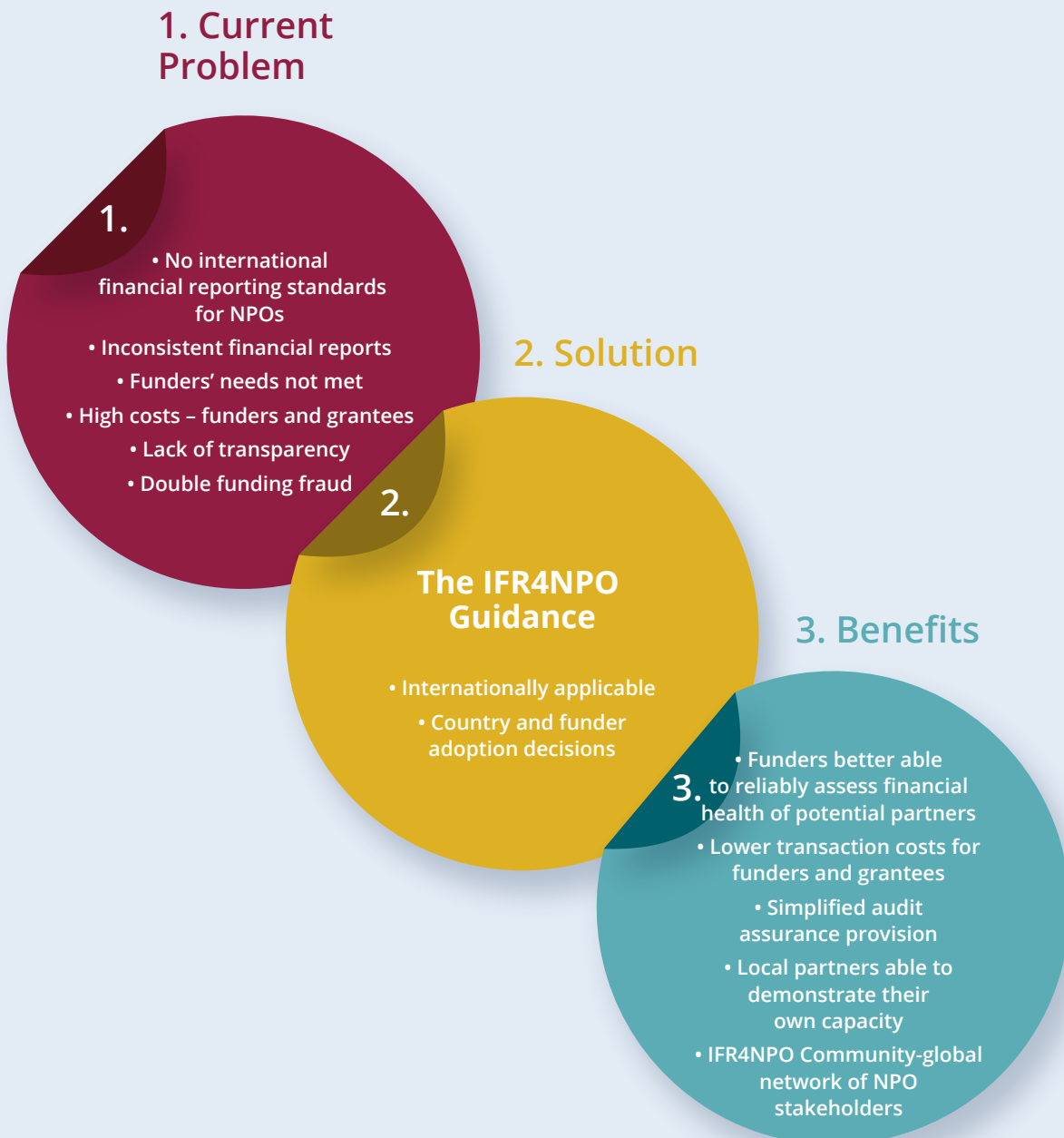
1.2.2 Greater consistency in reporting will provide a basis for comparison between organisations and jurisdictions. This will improve the environment for the effective regulation of the sector, both nationally and internationally.

1.2.3 With funders better able to reliably assess the financial health of potential partners, higher quality more reliable financial reports should also lead to lower costs for funders and grantees seeking grants or donations. Improved financial reporting should also allow grantees to demonstrate their capacity and take advantage of simplified audit assurance arrangements.

1.2.4 To deliver these outcomes, the central output of the project is a single set of financial reporting Guidance for NPOs that can be applied internationally. The Guidance will provide a set of tools to help NPOs prepare their accounts. This Guidance will take account of the accountability and general information needs of NPO stakeholders.

1.2.5 This concept of accountability includes a broader accountability to civil society as well as specific stakeholders. This type of accountability is not unique to NPOs. For example, in the public sector there is a concept of public accountability that comes from the provision of services from compulsory taxation revenues. In the private sector public accountability is deemed to exist where an entity has publicly traded debt and shares. Public accountability in this case is essential to the efficient and effective operation of public markets in such financial assets and services.

Figure 1.1 Project context



- 1.2.6** The Guidance will help national standard setters where no NPO-specific accounting standards or guidance exists. It will provide the starting point for a more coordinated approach that prevents differences emerging amongst jurisdictions.
- 1.2.7** The intention is that the Guidance is updated periodically in line with its foundational base. So, if the *IFRS for SMEs* Standard is adopted as the foundational base of the Guidance an update to the Guidance for NPOs would commence following each update to the *IFRS for SMEs* Standard. The *IFRS for SMEs* Standard has been updated at broadly five year intervals in the past.
- 1.2.8** In the longer term, the Guidance can form the basis for more comprehensive international NPO standards if there proves to be a demand, and development resources available.
- 1.2.9** Materials including training resources to help NPOs adopt the Guidance once it has been finalised are the other key project outputs. The project is seeking to build a diverse global community of those with a stake in NPO financial reporting. This outcome is an important enabler for the development and maintenance of sustained strong financial management into the future.

2. Developing the Guidance

2.1 Project arrangements – partners and contributors

- 2.1.1** The project is being delivered by a partnership between Humentum and the Chartered Institute for Public Finance and Accountancy (CIPFA).
- 2.1.2** CIPFA is a UK based charity with a Royal Charter, which has the aim of strengthening public financial management and governance. CIPFA is the only professional accountancy organisation focusing on public and non-profit sectors internationally. CIPFA has unique standing setting roles for local government and charities in the UK. CIPFA is leading on the technical development aspects of the project.
- 2.1.3** Humentum provides training, consulting and convening around the world for non-profit organisations. Humentum provides practical solutions, expertise and professional communities for social sector organisations to strengthen their core capabilities and achieve greater impact. Key areas of focus are compliance, financial management, programme management and people development. Humentum is leading on the stakeholder engagement aspects of the project.
- 2.1.4** Both organisations are respected in their fields and have relationships with a wide range of sector stakeholders. This includes NPOs, funders, standard setters and the accountancy community, whose buy-in is necessary for success.
- 2.1.5** The project team has a Steering Group that is providing oversight. The Steering Group has three non-executive members and two executive members.⁵²
- 2.1.6** The project is being funded by voluntary contributions. The Ford Foundation and the Open Society Foundation have provided seed funding that has enabled the project to commence and for this Consultation Paper to be produced.
- 2.1.7** The costs of completing the project will need to be provided by further grants and donations by multiple donors. The project is being managed so that no one contributor can influence the development of the Guidance.

2.2 Advisory Groups

- 2.2.1** The project has convened international professional Advisory Groups to support the Guidance development process: The Technical Advisory Group

⁵² Further information about the Steering Group and its role can be found at www.ifr4npo.org/about/project-governance/.

brings the rigour of national standard setters, and the Practitioner Advisory Group draws on the experience and perspectives of a diverse range of sector stakeholders from all over the world.

- 2.2.2** CIPFA chairs the Technical Advisory Group (TAG). The TAG membership comprises individuals from several national standard setters or their nominees. The TAG also includes a formal observer from the International Accounting Standards Board. TAG members sit as individuals rather than as authorised representatives of their individual bodies and participate due to their expertise in standard setting. Their role is to provide technical rigour in their advice on the development of the Guidance. Meetings are public with the meeting papers, recordings of the meetings and a summary of the main points available on the project website.⁵³
- 2.2.3** Humentum chairs the Practitioner Advisory Group (PAG). The Practitioner Advisory Group is drawn from multiple stakeholder groups that have an interest in NPO financial reporting from across the world. This includes NPOs, funders, auditors, academics and regulators. Their role is to provide advice on the practical issues associated with the development of the Guidance. As with the TAG, meetings are a matter of public record, with meeting papers, recordings of meetings and a summary of the main points available on the project website.⁵⁴

2.3 Delivery and engagement

- 2.3.1** The process of developing the Guidance is designed to be as collaborative and inclusive as possible. This is to properly reflect the concerns, issues and needs of the NPO community. The aim is to maximise the opportunity for the Guidance to be relevant to the sector and usable by all stakeholders. Contribution and participation is actively encouraged. Figure 2.1 shows global engagement as at 31 December 2020.
- 2.3.2** Country Champions from around the world have been appointed to support awareness raising and provide information about the project. Their local activities are being supported by materials provided by the project team, including webinars and discussion forums.⁵⁵ The project is aiming to keep the NPO community informed about key developments and involved in discussions so that it can have a say about matters that are of greatest concern.

⁵³ More information about the TAG and its membership can be found at: www.ifr4npo.org/technical-advisory-group/.

⁵⁴ More information about the PAG and its membership can be found at: www.ifr4npo.org/practitioner-advisory-group/.

⁵⁵ Available via the project website at: www.ifr4npo.org/forums/.

Figure 2.1: Stakeholder engagement as at 31 December 2020



2.3.3 Technically, the Guidance is being developed following the tried and tested methodology used in international accounting standard setting in the private and public sectors. This follows the three-step process of Consultation Paper, followed by an Exposure Draft, before issue of the final formal guidance. This will mean that the Guidance is being developed in a robust and transparent manner.

2.3.4 The Technical Advisory Group considers proposals for the documents that are formally issued by the project and provides advice on their content. All these papers and the deliberations of the TAG are in the public domain. Advice is also sought from the Practitioner Advisory Group to get a perspective from the varied stakeholder groups on proposals. The advice from both bodies are used to further develop the content. There is a feedback loop between the bodies.

2.3.5 Following the issue of this Consultation Paper, and in the next phase, the Exposure Draft, there will be a series of regional consultation meetings. These will be designed to engage on a range of points from formal documents issued and to seek feedback. This feedback will complement formal written consultation responses and provide the opportunity to interact with the NPO community.

3. Defining NPOs

3.1 Context

- 3.1.1** Understanding which organisations are NPOs and might benefit from the Guidance is an important question both for the project and for the regulators who might seek to use the Guidance in their jurisdictions.
- 3.1.2** NPOs need to be defined so that in considering the financial reporting issues, the potential application to relevant organisations can be considered, ie which organisations might benefit from the Guidance and how. With the breadth of the sector and differences in jurisdictions, developing a single definition that accommodates the range of organisations that might be expected to fall within the scope of the Guidance is challenging.
- 3.1.3** Establishing a single definition for the entities that might use public sector accounting standards was a challenge also faced by the International Public Sector Accounting Standards Board (IPSASB). The Preface to the IPSASB Standards sets out the scope of the Standards and does this in a narrative form to give guidance as to the entities expected to be covered by the Standards. It says:
- “The IPSAS are designed to apply to public sector entities⁵⁶ that meet all of the following criteria:
- a.** Are responsible for the delivery of services⁵⁷ to benefit the whole of the public and/or to redistribute income and wealth;
 - b.** Mainly finance their activities, directly or indirectly, by means of taxes and/or transfers from other levels of government, social contributions, debt or fees; and
 - c.** Do not have a primary objective to make profits.”
- 3.1.4** An approach that adopts a narrative set of descriptions to characterise the purpose and objectives of NPOs is proposed in Part 1: Chapter 1. These characteristics seek to scope out those organisations that in essence, might be for-profit entities and those organisations that might in essence be public sector entities and not anticipated to fall within this Guidance.

⁵⁶ Paragraph 1.8 of *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* identifies a wide range of public sector entities for which IPSASs are designed.

⁵⁷ Services encompasses goods, services and policy advice, including to other public sector entities.

3.2 Previous research

- 3.2.1** In 2014, a report issued by the Consultative Committee of Accountancy Bodies in the UK (CCAB Report),⁵⁸ the definition of NPOs was reported as an issue by survey respondents. The report described terms to describe non-profit entities (NPOs), non-government organisations (NGOs), charities, public benefit entities, voluntary organisations, donee organisations, membership organisations, professional associations, societies, mutual and non-investor-owned social enterprises. Importantly it noted that these terms can have different meanings in different jurisdictions and to that contained in law.
- 3.2.2** The report examined differences between NPOs, for-profit entities and public sector entities across four factors: ownership (including constitutional form and management control), beneficiaries, social purpose and financing, as a way of differentiating organisations.
- 3.2.3** Academic studies and statistical guides have sought to develop international classification frameworks for NPOs by focusing primarily on the structural and operational features of entities. These include the System of National Accounts developed by the United Nations and *The International Classification of Non-profit Organisations* from the Johns Hopkins Institute for Policy Studies.⁵⁹ The common approach of these frameworks is that an entity is deemed to be an NPO if it is:
- **An organisation** – institutionalised to some extent even if not a legal entity
 - **Self-governing** – in control of its own activities
 - **Private** – institutionally separate from government
 - **Voluntary/non-compulsory** – participation in the entity's activities and contributions to it are a free choice
 - **Non-profit distributing/significantly limited in distribution of surpluses** – any profits or surpluses generated are not returned to owners for private gain and the entity is not primarily guided by commercial considerations.
- 3.2.4** In addition to examining these structural and operational features, a more granular classification of NPOs can also be made based on:
- **the activities that an NPO undertakes** – is it is focused on providing services related to for example healthcare, education, sanitation, housing or advocacy

⁵⁸ International financial reporting for the not-for-profit sector – A study commissioned by CCAB published February 2014.

⁵⁹ See Salamon, L. M., & Anheier, H. K. (1996). *The International Classification of Nonprofit Organizations: ICNPO-Revision 1*, 1996. Baltimore, Md, Johns Hopkins Institute for Policy Studies, and also https://unstats.un.org/unsd/nationalaccount/docs/UN_TSE_HB_FNL_web.pdf

- **the sources of its funding** – does the entity receive funding only from a small number of local or national donors, or does it manage grants on an international level and in turn awards sub grants to other entities
- **the locations in which it operates** – does the entity provide services in only a single local area or region, has it a national focus, or is it operating across borders/internationally.

3.2.5 These classifications have strongly influenced the NPO broad characteristics proposed in Part 1: Chapter 1. These broad characteristics include for example public benefit objectives and the non-distribution of surpluses. A greater focus has been placed, however, on economic events and transactions that are relevant to the development of principle-based financial reporting guidance. These include a focus on voluntary donations and grant funding and restrictions that can be placed on such funding, and how assets are held and used to deliver services rather than for cash-generation.

3.3 Jurisdictional-level approaches

3.3.1 At the jurisdictional-level there is often a focus on legal concepts that are not as easily or readily able to be applied internationally. This includes concepts such as ‘charitable purposes’ that have a specific meaning within certain jurisdictions. In addition to not being internationally applicable, these legal concepts can also exclude entities within jurisdictions. For example, in some jurisdictions an entity may not be seen as an NPO if it is providing services that are narrowly focused on a specific group.

3.3.2 As well as regulation and taxation, financial reporting is an area that highlights how jurisdictions can take their own approach to defining which entities are seen as NPOs. At a jurisdictional level there can be a focus on whether an organisation meets the definition of a ‘public benefit entity’, and the extent that the entity is permitted to generate profit/surpluses as part of meeting its primary objectives and then distribute these to owners or members. While this reflects aspects of the international classification framework, it is also clear that each jurisdiction defines what an NPO is based on their own requirements and the wider legal and regulatory framework in place.

Figure 3.1: Examples of jurisdictional-level definitions of NPOs for financial reporting



Canadian GAAP incorporates a test of public benefit purpose but also focuses specifically on the not-for-profit characteristics of an entity and in particular financial returns, defining a not-for-profit organisation (NFPO) as being: “an entity, normally without transferable ownership interests, organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose. An NFPO’s members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization.” Preface to the CPA Canada Handbook - *Accounting*, paragraph 3(c) – April 2019



New Zealand’s accounting standards framework for for-profit and public benefit entities (both not-for-profit and public sector entities), defines public benefit entities “as reporting entities whose primary objective is to provide goods or services for the general public or social benefit and where any equity has been provided with a view to supporting that primary objective rather than with a view to providing a financial return to equity holders.” External Reporting Board Standard A1 – *Application of the Accounting Standards Framework – Appendix A* – External Reporting Board New Zealand – May 2019



The Financial Reporting Council in the UK when developing FRS 102 (which also applies to those entities that are not profit oriented) noted that a public benefit entity is: “An entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any equity is provided with a view to supporting the entity’s primary objectives rather than with a view to providing a financial return to equity providers, shareholders or members.” *FRS 102 The Financial Reporting Standard Applicable in the UK and the Republic of Ireland* – Financial Reporting Council – March 2018

- 3.3.3** Jurisdictions also often require NPOs to apply different financial reporting standards based on their size and complexity. This is usually determined using financial statement measures such as how much income an entity receives per year or its level of expenditure. From an international perspective what is deemed to be a relatively small NPO in one jurisdiction may be seen as large in another. It will be for individual jurisdictions to determine, based on local circumstances, to whom the Guidance applies where it is adopted.
- 3.3.4** This Guidance, using its broad characteristics approach, has been prepared to be as widely adopted as possible and not to limit its international applicability. Practically as outlined in Part 1: Chapter 5 it is proposed to be focused on those entities that have the most pressing needs.

4. Historical context

4.1 CCAB 2014 Report

4.1.1 In 2013, the Consultative Committee of Accountancy Bodies (CCAB), the coordinating body for the UK and Ireland's Professional Accountancy Organisations, provided the funds for an independent study on the need for international financial reporting standards for NPOs.

4.1.2 The study, which was focused on NPOs that are;

- constituted on a not-for-profit basis
- self-governing
- established for public benefit.

It included an online survey in English carried out in late 2013. The survey included 19 core areas, with both closed and open questions that allowed narrative comments. It was circulated widely through international contacts held by the CCAB steering group.

4.1.3 There were 605 usable responses, providing direct experiences of NPO financial reporting in 179 countries. These responses contained a lot of detail, with two thirds of respondents completing most of the narrative questions. Responses came from NPOs of all sizes.

4.1.4 The resulting report published in 2014, built a robust evidence base for the need for an international reporting standard for the NPO sector. Overall, 72% of the 605 survey respondents across the 179 countries agreed that such a standard would be useful.

4.1.5 The study raised several issues, notably the diversity of requirements placed on NPOs. These were often linked to an NPO's legal form, for example, many jurisdictions placed requirements on NPOs structured as companies which did not apply to other NPOs. The report noted that the scope of NPOs could be wide (see Section 3 below).

4.1.6 The study also noted that financial reporting requirements ranged from very specific NPO standards to no standards at all. For example the study highlighted that the UK Charities SORP (Accounting and Reporting by Charities: Statement of Recommended Practice) is very detailed and specific, in Australia a sector neutral approach was adopted with some guidance for NPOs, and in South Africa no separate accounting standards were issued and NPOs applied IFRS. The study also noted that where countries did require application of IFRS, the extent of application especially to small NPOs was raised as questionable. It also identified areas of difference in accounting treatments in specific areas. These have been considered in Part 2 of this Consultation Paper.

4.1.7 The study set out a number of options to address these issues, including both specific international accounting standards and guidance. However, it concluded that more analysis and discussion would be needed by interested parties to determine the best way forward, with the findings of the report having the potential to inform this debate.

4.2 ACCA Companion Guide

4.2.1 In 2015, in the UK, the Association of Chartered Certified Accountants (ACCA) issued a companion guide *Companion Guide for Not-for-profits to the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)*. The guide was written in response to the lack of formal guidance to help NPOs prepare financial accounts under a robust, but appropriate framework. The foreword to the guide says "... as a consequence of the IASB's focus on for-profit organisations, there are times when the outcome of applying the [IFRS] SME Standard to not-for-profit organisations will not provide a perfect representation of the results of those entities."

4.2.2 The objective of the Companion Guide is to provide assistance to not-for-profit entities that may wish to prepare reports on the basis of the *IFRS for SMEs* Standard. It identifies a number of issues for not-for-profit organisations and seeks to provide guidance to sit alongside the *IFRS for SMEs* Standard to address those issues. These issues have also been incorporated into the issues included in Part 2: Overview of the Consultation Paper.

4.3 IFASS Working Group

4.3.1 The International Forum of Accounting Standard Setters (IFASS) is a grouping of national accounting standard-setters from around the world, plus other organisations that have a close involvement in financial reporting issues. Following a meeting of IFASS in April 2016, an informal grouping of some of these standard setters and other organisations with an interest in non-profit reporting was formed.

4.3.2 The Group had ten member countries represented and was chaired by CIPFA, who also provided the Secretariat. Consistent with the position of the IFRS Foundation that its focus is on for-profit organisations, the IASB participated as an observer. The group has discussed the most pressing issues being encountered by national standard setters for this sector.

4.3.3 The Working Group developed a list of issues and brought together information from Working Group participants about the various accounting treatments in their jurisdictions. The issues identified by the Working Group have been incorporated to the issues included in Part 2: Overview of the Consultation Paper.



International and national financial reporting standards and guidance

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1. International reporting frameworks

1.1 International Financial Reporting Standards (IFRS)

IFRS Standards are set by the International Accounting Standards Board (IASB), the standard-setting body of the IFRS Foundation. The IFRS Foundation is a not-for-profit, public interest organisation established to develop a single set of globally accepted accounting standards and to promote and facilitate adoption of the standards in order to:

- Bring transparency by enhancing the international comparability and quality of financial information, enabling investors and other market participants to make informed economic decisions.
- Strengthen accountability by reducing the information gap between the providers of capital and the people to whom they have entrusted their money. IFRS Standards provide information needed to hold management to account. As a source of globally comparable information, IFRS Standards are also of vital importance to regulators around the world.
- Contribute to economic efficiency by helping investors to identify opportunities and risks across the world, thus improving capital allocation. Use of a single, trusted accounting language lowers the cost of capital and reduces international reporting costs for businesses.

IFRS Standards are developed to be used primarily by publicly accountable companies – defined by the IASB as those listed on a stock exchange and financial institutions such as banks that hold financial assets in a fiduciary capacity.

1.2 The *IFRS for SMEs* Standard

In addition to full IFRS Standards, within the IFRS suite of standards the *IFRS for SMEs* Standard provides for simplified reporting requirements for for-profit organisations to meet the needs of smaller organisations.

The *IFRS for SMEs* Standard is a self-contained Standard (fewer than 250 pages) designed to meet the needs and capabilities of small and medium-sized entities (SMEs), which are estimated to account for more than 95% of all companies around the world.

The *IFRS for SMEs* Standard is available for any jurisdiction to adopt, whether or not it has adopted full IFRS Standards. Each jurisdiction must determine which entities should use the Standard. The IASB's only restriction on use is that entities that have public accountability (as defined in IFRS) should not use it. Such entities are required to apply full IFRS Standards if IFRS is adopted.

1.3 International Public Sector Accounting Standards (IPSAS)

IPSAS are set by the International Public Sector Accounting Standards Board (IPSASB) whose financial, operational and administrative operations are supported by the International Federation of Accounts (IFAC). IPSASB has independence of decision-making within IFAC and its objective is to serve the public interest by developing high-quality accounting standards and other material for use by public sector entities around the world in the preparation of general purpose financial reports. This is intended to enhance the quality and transparency of public sector financial reporting by providing better information for public sector financial management, accountability and decision making.

In pursuit of this objective, the IPSASB supports the convergence of international and national public sector accounting standards and the convergence of accounting and statistical bases of financial reporting where appropriate; and also promotes the acceptance of its standards and other publications.

IFRS Standards alignment has been a key pillar of IPSAS development since its inception, as in many instances government and corporate activities are the same and there are clear advantages of using common global financial reporting approaches.

As such a formal alignment process exists to assess the applicability of IFRS Standards in the public sector context. This includes determining whether there are public sector issues that warrant departure from IFRS Standards and if so whether this requires a separate public sector project or instead the modification of an IFRS (for example changing recognition and measure requirements or eliminating accounting treatments) to reflect the public sector context.

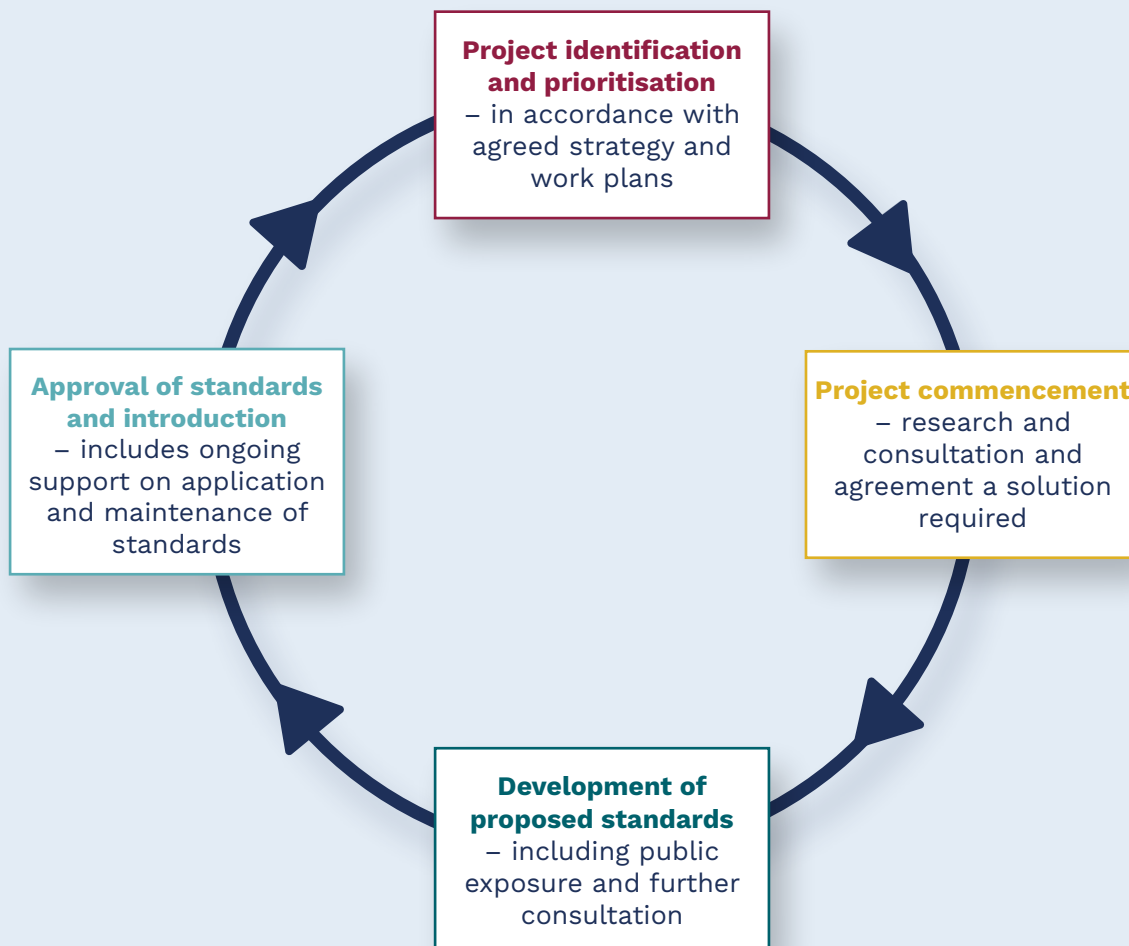
This alignment process works to minimise the differences between the IFRS and IPSAS financial reporting frameworks, so that as far as possible a similar transaction or economic event will be accounted for in the same way by a public or private sector entity. An example of the alignment dashboard can be found at: https://www.ifac.org/system/files/meetings/files/1-1.5-IPSAS-IFRS-Alignment-Dashboard_Final_0.pdf

2. International standards development

Both IFRS Standards and IPSAS are set using similar thorough, transparent and participatory due processes.

This ongoing process of standards setting and maintenance means that the frameworks adapt to user needs through new standards or amendments to existing standards. It does mean however that they can be subject to frequent update which can impact on ease of use.

Figure 2.1: International standard setting – due process



In this regard the *IFRS for SMEs* Standard is different. As indicated to reduce burdens revisions to this Standard are limited, with a commitment from the IASB only to update the entire Standard and to ensure that there are at least three years between revisions. The *IFRS for SMEs* Standard was last amended in October 2015, with an effective date of application of 1 January 2017. It is currently under a comprehensive review which began in 2019. Among other activities the Board is undertaking outreach to gain a broad range of views on the extent to which the *IFRS for SMEs* Standard should be aligned with full IFRS Standards.

3. Comparison of the conceptual frameworks underpinning the international frameworks

| IASB Framework for IFRS | IPSASB Framework for IPSAS | Differences |
|---|---|---|
| <p>Objective of general purpose financial reporting – The objective of general purpose financial reporting, which is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.</p> | <p>Objective of financial reporting – The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFs for accountability purposes and for decision-making purposes. Users are service recipients and resource providers who do not possess the authority to require a public sector entity to disclose the information they need for accountability and decision-making purposes.</p> | <p>IPSASB Framework has specific objective emphasising importance of accountability in the public sector. The IASB Framework acknowledges the assessment of management’s stewardship of the entity’s economic resources as an aspect of decision making.</p> <p>Different users reflecting different objectives of entities at which the Frameworks are directed.</p> |
| <p>Qualitative characteristics of, and the cost constraint on, useful financial information – If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable. Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting.</p> | <p>Qualitative characteristics –The qualitative characteristics of information included in GPFs of public sector entities are relevance, faithful representation, understandability, timeliness, comparability, and verifiability. Pervasive constraints on information included in GPFs are materiality, cost-benefit, and achieving an appropriate balance between the qualitative characteristics.</p> | <p>While the qualitative characteristics (QC) are the same IPSASB Framework does not distinguish fundamental and enhancing characteristics.</p> <p>IPSASB Framework does not address prudence as aspect of neutrality in QC of faithful representation.</p> <p>IASB Framework does not discuss materiality and balancing of QCs as pervasive constraints.</p> <p>IASB Framework contains more granular discussion of materiality incorporating consequential amendments from IAS 1 <i>Presentation of Financial Statements</i>, and IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>.</p> |
| <p>Financial statements and the reporting entity – A reporting entity is an entity that is required, or chooses, to prepare financial statements. A reporting entity can be a single entity or a portion of an entity or can comprise more than one entity. A reporting entity is not necessarily a legal entity. Financial statements are prepared for a reporting period and provide financial information about the reporting entity’s assets, liabilities, equity, income and expense.</p> | <p>Reporting entity – A public sector reporting entity is a government or other public sector organisation, program or identifiable area of activity that prepares GPFs. A public sector reporting entity may comprise two or more separate entities that present GPFs as if they are a single entity – such a reporting entity is referred to as a group reporting entity. GPFs encompass financial statements and information that enhances, complements and supplements the financial statements. Financial statements present information about the resources of the reporting entity or group reporting entity and claims to those resources at the reporting date, and changes to those resources and claims and cash flows during the reporting period.</p> | <p>IASB Framework has a section on the Objective and Scope of Financial Statements.</p> <p>IASB has sections on Reporting Period and Perspectives Adopted in Financial Statements</p> <p>IPSASB scope is broader – general purpose financial reports.</p> |

| IASB Framework for IFRS | IPSASB Framework for IPSAS | Differences |
|---|--|---|
| <p>Elements of financial statements – Financial statements elements are (a) assets, liabilities and equity, which relate to a reporting entity's financial position and (b) income and expenses, which relate to a reporting entity's financial performance.</p> | <p>Elements in financial statements – The elements are assets, liabilities, revenue, expense, ownership contributions and ownership distributions. This does not preclude IPSASs from requiring or allowing the recognition of resources or obligations that do not satisfy the definition of these elements when necessary to better achieve the objectives of financial reporting.</p> | <p>IPSASB Framework defines ownership contributions and ownership distributions, which are not defined in IASB Framework.</p> <p>IPSASB Framework does not define equity, which is defined in IASB Framework.</p> <p>The definitions of an asset are very similar. However, the IASB description of an economic resource refers to a "right that has the potential to produce economic benefits." The IPSASB description of a resource refers to an "item with service potential or the ability to generate economic benefits".</p> <p>The definitions of a liability are very similar. The IASB definition of a liability refers to "a present obligation to transfer an economic resource"; the IPSASB definition refers to a "present obligation of the entity for an outflow of resources".</p> <p>IPSASB Framework does not relate elements to specific financial statements.</p> <p>IPSASB Framework includes other economic phenomena – other resources and other obligations.</p> <p>IASB Framework has sections on unit of account and executory contracts.</p> <p>IASB Framework has section on 'Substance of contractual rights and contractual obligations.' No equivalent section in IPSASB Framework.</p> |
| <p>Recognition and derecognition – Recognition is the process of capturing for inclusion (in monetary value and words) in the statement of financial position or the statement of financial performance an item that meets the definition of one of the elements of financial statements. Derecognition is the removal of all or part of a recognised asset or liability from an entity's statement of financial position.</p> | <p>Recognition in financial statements – Recognition is the process of incorporating and including in amounts displayed on the face of the appropriate financial statement an item that meets the definition of an element and can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information included in GPFRs. Derecognition is the process of evaluating whether changes have occurred since the previous reporting date that warrant removing an element that has been previously recognised from the financial statements, and removing the item if such changes have occurred</p> | <p>IASB Framework relates existence uncertainty and low probability of an inflow or outflow of economic benefits to relevance and measurement uncertainty and other factors to faithful representation.</p> <p>IPSASB Framework does not relate existence uncertainty and measurement uncertainty to particular QCs.</p> |

| IASB Framework for IFRS | IPSASB Framework for IPSAS | Differences |
|---|---|---|
| <p>Measurement – Quantifying elements recognised in financial statements in monetary terms requires the selection of a measurement basis which is an identified feature, such as historical cost or fair value, of an item being measured.</p> | <p>Measurement of assets and liabilities in financial statements – The objective of measurement is to select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes.</p> | <p>IASB Framework does not have a measurement objective. Includes sections on ‘Information provided by particular measurement bases’ and on ‘Factors to consider when selecting a measurement basis.’</p> <p>IPSAS Framework has a measurement objective based on provision of information on operational capacity, financial capacity and cost of services.</p> <p>IASB Framework includes current cost as a current value measurement basis, which can be ascertained through direct or indirect inputs.</p> <p>IPSASB Framework uses ‘entry’ and ‘exit’ distinction in the analysis of measurement bases. The IASB Framework explicitly rejects this distinction.</p> <p>IPSAS Framework does not include fair value but does include market value (pre-IFRS 13 definition of fair value) for both assets and liabilities.</p> <p>IPSAS Framework includes depreciated replacement cost as measurement basis in own right rather than as measurement technique for fair value.</p> <p>IPSAS Framework includes net selling price (asset), cost of release (liability) and assumption price (liability).</p> <p>IASB Framework has sections on ‘Measurement of equity’ and ‘Cash-flow-based measurement techniques’</p> <p>IASB chapter is more detailed, for example IASB chapter includes a matrix summarizing information provided by measurement bases.</p> |

| IASB Framework for IFRS | IPSASB Framework for IPSAS | Differences |
|--|---|---|
| <p>Presentation and disclosure – The reporting entity communicates information about its assets, liabilities, equity, income and expenses by presenting and disclosing information in its financial statements.</p> | <p>Presentation in General Purpose Financial Reports – Presentation is the selection, location and organisation of information that is reported in the GPFRs. Presentation aims to provide information that contributes towards the objectives of financial reporting and achieves the qualitative characteristics while taking into account the constraints on information. Decisions on selection, location and organization of information are made in response to the needs of users.</p> <p>GPFRs are likely to comprise multiple reports, each responding more directly to certain aspects of the objectives of financial reporting and matters included within the scope of financial reporting. In addition to the financial statements, GPFRs provide information relevant to, for example, assessments of an entity's service performance and the sustainability of its finances. The objectives of financial reporting, applied to the area covered by a particular report, guide presentation decisions for that report.</p> | <p>Different scope. IPSASB Framework has a wider scope encompassing financial reports outside the core financial statements. IASB scope is financial statements.</p> |
| <p>Concepts of capital and capital maintenance – Selection of the appropriate concept of capital by an entity based on the needs of the users of its financial statements. A financial concept of capital equates capital to net assets or equity of the entity. A physical concept regards capital as the productive capacity of the entity.</p> | <p>The IPSAS Conceptual Framework does not currently have a chapter of concepts of capital and capital maintenance. The IPSASB is currently considering appropriate alignment to the IFRS conceptual framework for capital and capital maintenance.</p> | <p>The IPSAS Conceptual Framework does not currently have a chapter of concepts of capital and capital maintenance. The IPSASB is currently considering appropriate alignment to the IFRS conceptual framework for capital and capital maintenance.</p> |

4. National standards and guidance for NPOs

4.1 Introduction

Some jurisdictions have developed accounting standards or guidance specifically for NPOs. Examples of national sector specific guidance is discussed in the Part 2: Sections 1 to 5 to illustrate the sometimes different approaches taken to NPO issues. These have been used to inform the building blocks for the alternative approaches that have been developed for each of the issues. Most of these examples have been drawn from New Zealand, Australia, Canada, the UK and the USA.

Included in this paper is additional information about how the frameworks, standards or guidance have been developed in the jurisdictions that have been most used in the Part 2 sections. This includes information about the basis of the guidance in the jurisdictions used in Part 2. It also includes information about how these national frameworks relate to the alternatives in Part 2 and how to locate guidance where this is in the public domain. The information provided here is not exhaustive and does not provide informational on all national standards across the world.

This additional may be useful to readers in understanding the different approaches taken to NPO issues. It may also be useful in considering the proposed way forward in Part 1: Chapter 5.

4.2 New Zealand

The New Zealand Accounting Standards Framework (the ASF) has two key objectives:

- i. to meet user needs by developing accounting standards that lead to high quality financial reporting that meets the different user needs in the for-profit and public benefit entity (PBE) sectors.
- ii. to balance the costs and benefits of reporting by establishing appropriate accounting requirements based on the nature and size of the entity.

The ASF establishes which suite of reporting standards and reporting tiers apply to which entities, through a multi-standard, multi-tiered approach.

The framework has three key elements:

Multi-standard: Different suites of accounting standards for two distinct sectors: **for-profit entities** and **public benefit entities (PBEs)**

Tiered approach: Different accounting requirements for each tier based on cost-benefit considerations – For-profit entities – **2 tiers**, PBEs – **4 tiers**.

Basis for developing each suite of accounting standards: For-profit entities – accounting standards are based on International Financial Reporting Standards (**IFRS Standards**). PBEs – accounting standards are based primarily on International Public Sector Accounting Standards (**IPSAS**) for Tiers 1 and 2 and the **XRB's Simple Format Reporting Requirements** for Tiers 3 and Tiers 4.

For Public Benefit entities, the Tier is based on whether the entity is deemed to have public accountability (societal accountability) and its level of expenses.

Figure 4.1: New Zealand tiers for Public Benefit Entity financial reporting

| Tier | Entity Type | Standards |
|---------------|--|---|
| Tier 1 | Has public accountability or is a large PBE with total expenses > \$30million | PBE Standards |
| Tier 2 | Has no public accountability, is not large, has total expenses < \$30million but > \$2million, and that elects to be in Tier 2 | PBE Standards Reduced Disclosure Regime (PBE Standards RDR) |
| Tier 3 | Has no public accountability and has total expenses ≤ \$2million, that elects to be in Tier 3 | PBE Simple Format Reporting Standard - Accrual (SFR-A) |
| Tier 4 | Has no public accountability and is allowed by law to use cash accounting, that elects to be in Tier 4. | PBE Simple Format Reporting Standard - Cash (SFR-C) |

4.3 United Kingdom

In the UK, Financial Reporting Standard 102 (FRS 102) is a single financial reporting standard that applies to the financial statement of entities not applying IFRS or the micro-entity standard (FRS 105). FRS 102 is designed to apply to the general purpose financial statements and financial reporting of entities including those that are not companies and those that are not profit-oriented.

It is based on the *IFRS for SMEs* Standard, but with significant modification both in terms of the scope of entities eligible to apply it and the accounting treatments provided. In addition to FRS 102, there are a number of additional Statement of Recommended Practices (SORPs). These are sector-driven recommendations on financial reporting that take into consideration sector specific context and prevailing economic events and transactions. There are, for example, SORPs applicable to NPOs that are registered as charitable organisations, providers of subsidised housing, and further education providers.

4.4 Australia

In Australia, the Australian Accounting Standards Board (AASB) uses IFRS Standards issued by the IASB to develop, issue and maintain Australian Accounting Standards for the not-for-profit (NFP) sector.

The accounting frameworks uses IFRS and transaction neutrality as a starting point, however, when justified, modifications are made to address:

- i. user needs
- ii. Australian-specific legislation
- iii. prevalence and magnitude of issues specific to the NFP sector
- iv. NFP application issues
- v. public interest issues relevant to financial reporting
- vi. undue cost or effort considerations.

This can result in modification to IFRS Standards via:

- i. 'Aus' paragraphs amending, adding or deleting an IFRS Standard's scoping, recognition, measurement, presentation or disclosure requirement (eg AASB 15 *Revenue from Contracts with Customers*) and/or
- ii. Australian-specific guidance in additional Appendices or specific examples (eg AASB 10 *Consolidated Financial Statements*).

The framework permits the AASB to address in NFP-specific standards, interpretations or guidance, NFP issues that have not been comprehensively or appropriately dealt with in existing IFRS Standards, including where no relevant IFRS Standard exists eg AASB 1054 *Australian Additional Disclosures*, AASB 1058 *Income of Not-for-Profit Entities*).

It also permits GPFS to be prepared using either Tier 1 (compliance with Australian Accounting Standards) or Tier 2 (compliance with Australian Accounting Standards – Reduced Disclosure Requirements).

4.5 Canada

In Canada, accounting standards for all entities outside the public sector are issued by the Accounting Standards Board (AcSB). The AcSB adopted IFRS Standards as the accounting standards used by publicly accountable enterprises. Private enterprises and private not-for-profit organisations can choose to apply either (a) the IFRS in Part 1 of the Accounting Handbook, or (b)

accounting standards for NFPOs in Part III supplemented, when appropriate, with standards for private enterprises in Part II of the Accounting Handbook.

In addition, Canada recognises the existence of government controlled not-for-profit enterprises. These entities fall in under the scope for PSA Handbook set by the PSAB and apply standards applicable to the public sector.

4.6 United States

In the United States, accounting standards for entities outside the public sector are issued by the Financial Accounting Standards Board (FASB). Authoritative generally accepted accounting principles (GAAP) are contained in the FASB's Accounting Standards Codification (the Codification), which the FASB updates regularly through the issuance of Accounting Standards Updates (ASUs). Besides applying all relevant general guidance within the Codification, not-for-profit entities have extensive incremental guidance within Topic 958, on non-exchange transactions, financial statement presentation, and various other not-for-profit-specific matters. There is no separate, simplified set of standards in GAAP that is equivalent to the *IFRS for SMEs* Standard; rather, the Codification contains various simplified accounting alternatives and many disclosure exemptions for business enterprises without public equity or debt. In most cases, these also apply to some or all not-for-profit entities.

Government-controlled not-for-profit entities (such as public universities and governmental hospitals) follow GAAP issued by the Governmental Accounting Standards Board (GASB), for state and local governments, or the Federal Accounting Standards Advisory Board (FASAB), for the Federal Government.

5. National frameworks additional information

Issue 1 – Reporting entity and control (including branches)

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|--|---|--|--|--|--|--|
| Alternative 1 Prepare additional NPO-specific guidance on the nature of reporting entities and use the principles based approach of substance over form to define control. | IFRS and IPSAS define control as when the entity is exposed, or has rights, to variable returns (IFRS10)/benefits (IPSAS 35) from its involvement and has the ability to affect the nature or amount of those benefits through the power it holds. | | Follows IFRS Standards with an Annex including application guidance for not for profit entities. | PBE IPSAS – Follows the IPSAS definition of control, and provides additional guidance on branches. | | |
| Alternative 2 Prepare additional NPO-specific guidance on the nature of reporting entities and use pragmatic methods of assessment such as the power to govern financial and operating policies to define control. | The <i>IFRS for SMEs</i> Standard defines control as the power to govern the financial and operating policies of an entity to obtain the benefits from its activities. Control is presumed when half of the voting power of an entity is owned, directly or indirectly. The standard also sets out when control may exist where ownership is less than 50%. | FRS 102 defines control as being the power to govern the financial and operating policy of an entity so as to obtain benefit from its activities. Section 9 of FRS 102 includes five situations where a parent has control over another entity. The Charities SORP includes specifications on how to account for branches. | | | One organisation is presumed to control another entity when it has the right to appoint the majority of the voting members of the other entity's board of directors. Additional guidance on indicators of control are also provided. | The direct or indirect ability to determine the direction of management and policies through ownership, contract, or otherwise. Consolidation is required when there is both and control and economic interest. One entity is presumed to control another entity when it has the right to appoint the majority of the voting members of the other entity's board of directors or trustees, or when it is the sole corporate member of the other entity. |

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|-----------------------------|---|--|---|---|---|--|
| Standards references | IFRS 10 paragraphs 6 & 7. IPSAS 35 paragraphs 19 & 20. IFRS for SMEs 9.4 & 9.5. | FRS 102, paragraph 9.4 & 9.5. Charities SORP, Section 25 provides guidance on branches. | AASB 10, Paragraphs 6 and 7 and Appendix E, Australian implementation guidance for not-for-profit entities. | PBE IPSAS 35, Paragraphs 18 – 20 <i>Explanatory Guide A8 Financial Reporting by Not-for-Profit Entities: The Reporting Entity</i> (EG A8), provides additional guidance on branches. | CPA Handbook – Accounting: Section 4450, <i>Reporting controlled and related entities by not-for-profit organizations</i> ; and CPA Canada Public Sector Accounting Handbook: PS 4250, <i>Reporting controlled and related entities by not-for-profit organizations</i>) | FASB ASC 958-810-25-1 – 5, Glossary definition 958-810-20. |

Issue 2 – NPOs that act on behalf of other entities

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|--|---|----|---|-------------|--------|-----|
| Alternative 1 Follow IFRS Standards - based on control with additional guidance and non-profit examples and with additional disclosure requirements. | IFRS 15 - an entity is principal if it controls the good or service before that service is passed to the customer. IFRS 10 specifies that an agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore does not control the investee when it exercises its decision-making authority. | | An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer. An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore does not control the investee when it exercises its decision-making authority. | | | |

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|---|--|---|-----------|-------------|---|--|
| <p>Alternative 2</p> <p>Follow the <i>IFRS for SMEs</i> Standard where decisions on agent and principal are made on an exposure to risks and rewards. Additional guidance and not for profit examples and with additional disclosure requirements.</p> | <p>The <i>IFRS for SMEs</i> Standard stipulates that the amounts collected on behalf of the principal are not revenue of the entity.</p> | <p>FRS 102 specifies that an entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. Amounts collected by an agent on behalf of a principal are not revenue. Revenue is the amount of commission.</p> <p>The Charity SORP stipulates that funds received by a charity as agent are not recognised as an asset in its accounts because the funds are not within its control. Therefore, the receipt of funds as agent is not recognised as income nor is its distribution recognised as the agent's expenditure.</p> <p>It requires disclosure of funds and balances held as agents and as 'custodian trustees'.</p> | | | <p>Section 3400 requires that revenue includes only gross inflows of economic benefits received by an enterprise on its own account. Amounts collected by an agent on behalf of a principal are not revenue.</p> <p>Under Section 3400, an entity is acting as a principal when it has exposure to the significant risks and rewards associated with transactions. This guidance includes features to consider that indicate when an enterprise is acting as a principal.</p> <p>Further application guidance for determining when amounts should be reported gross versus net is also provided. This includes indicators that suggest when gross and net reporting should be used.</p> | <p>An agency transaction is a type of exchange transaction in which the reporting entity acts as an agent, trustee, or intermediary for another party that may be a donor or donee.</p> <p>Whether a recipient NPO that is an intermediary is either principal (or agent) is dependent on whether an NPO has the discretion in the distribution of the money to the beneficiaries</p> <p>Substantial guidance is provided to determine if the intermediary has discretion. If such a discretion exists or if an NPO is a financially related entity an NPO is principal in the transactions. If not it recognises an asset and a liability (for amounts which have not yet been distributed.</p> |

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|--|---|----|-----------|--|--------|-----|
| Alternative 3 Follow IPSAS where decisions on agent and principal are made on an exposure to risks and rewards. Additional guidance and not for profit examples and with additional disclosure requirements. | IPSAS 9 requires entities to determine when they have exposure to the significant risks and rewards associated with the sale of goods or rendering of services. Amounts collected as an agent of the government or other organisation will not give rise to an increase in net assets or revenue of the agent. IPSAS 35 has similar guidance to IFRS 10 described above. | | | PBE IPSAS 9 Amounts collected as an agent of the government or another government organisation or on behalf of other third parties are not economic benefits or service potential that flow to the entity, and do not result in increases in assets or decreases in liabilities. | | |

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|-----------------------------|---|--|--|---|---|--|
| Standards references | IFRS 15 <i>Revenue from Contracts with Customers</i> , IFRS 10 <i>Consolidated Financial Statements</i> , IASB <i>Conceptual Framework for Financial Reporting</i> (March 2018). The <i>IFRS for SMEs</i> Standard section 23. IPSAS 9 <i>Revenue from Exchange Transactions</i> , IAS 35 <i>Consolidated Financial Statements</i> , and IPSASB <i>Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities</i> (IPSASB October 2014). | FRS 102 Section 23, <i>Revenue</i> , Appendix 1 <i>Definitions</i> , Charities SORP (FRS 102) (Second Edition) Module 19 <i>Accounting for funds received as agent or as custodian trustee</i> . | AASB 15 <i>Revenue from Contracts with Customers</i> | PBE IPSAS 9 <i>Revenue from Exchange Transactions</i> | CPA Canada Handbook - Accounting, Section 3400 <i>Revenue</i> | ASC 958-605-20, 958-605-25-23 to 958-605-25-27 and 958-605-55-75 to 958-605-55-79. |

Issue 3 – Non-exchange revenue

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|--|---|----|--|-------------|---|-----|
| Alternative 1 Use recognition and measurement principles from the <i>IFRS for SMEs</i> Standard with additional NPO-specific guidance. | The <i>IFRS for SMEs</i> Standard provides specific guidance for revenue from government grants; section 2 provides concepts and pervasive principles for other non-exchange revenue. | | | | | |
| Alternative 2 Recognise all non-exchange revenue using the principles in IAS 20. NPO-specific guidance is provided. | IAS 20 requires government grants with conditions to be recognised on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. | | Non-exchange revenue (the excess of the carrying amount of the asset recognised over any related amounts required to be recognised under other standards) is recognised immediately except where the transaction requires an NPO to acquire or construct a non-financial asset. Under AASB 1058, an NPO can recognise volunteer services at fair value if they can be measured reliably, regardless of whether the services would have been purchased if they had not been donated. | | Donations with conditions can be recognised using the deferral method, with donations recognised in the period related to the corresponding expenses (depreciation if capital). Alternatively, it is permitted for revenue to be recognised immediately, but presented as part of a separate restricted fund, showing the related expenses. Services in-kind are permitted to be recognised at fair value if they can be measured reliably and would otherwise have been purchased or to construct an asset. | |

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|---|--|----|-----------|---|--------|--|
| <p>Alternative 3 Recognise non-exchange revenue using the principles in IPSAS 23. NPO-specific guidance is provided.</p> | <p>IPSAS 23 and ED 71 require donations to be recognised as conditions are satisfied and provide exceptions for the recognition of services in-kind.</p> | | | <p>NPOs are permitted not to recognise gifts in-kind that meet the definition of inventories as assets if it is not practicable to reliably measure their current value. Gifts in-kind for resale give rise to revenue when they are sold. No revenue is recognised in respect of gifts in-kind for distribution to beneficiaries.</p> <p>NPOs are permitted, but not required, to recognise revenue from services in-kind that can be reliably measured at fair value.</p> | | <p>NPO are required to recognise donations with conditions as the conditions are satisfied. NPOs are not required to recognise contributions of art, historical treasures, and similar items if they are added to collections.</p> <p>Additional guidance is provided on assessing fair value for gifts in-kind and donated fixed assets.</p> <p>Services in-kind are required to be recognised (at fair value) where they either create or enhance a non-financial asset; or require skilled labour that would need to have been purchased if not provided by donation.</p> |

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|--|--------------------------|---|-----------|-------------|--------|-----|
| Alternative 4 Recognise non-exchange revenue using the principles in IPSAS 23. Introduce exceptions to the requirements for gifts in-kind based on some national standards. NPO-specific guidance is provided. | | <p>Revenue from government grants and other non-exchange revenue are permitted to be recognised as conditions are satisfied.</p> <p>Revenue from gifts in-kind are permitted to be recognised when the items are sold or distributed when it is impractical to recognise inventory on receipt. Items distributed at no cost, are recognised as an expense and revenue when issued.</p> <p>Services in-kind are recognised when they can be reliably measured. Services that would have otherwise been purchased are recognised at the value to the entity; other services are recognised at a fair value.</p> | | . | | |

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|-----------------------------|--|--|---|---|--|--|
| Standards references | IFRS 15 <i>Revenue from Contracts with Customers</i> ; IAS 20 <i>Accounting for Government Grants and Disclosure of Government Assistance</i> ; <i>Conceptual Framework</i> ; Section 2, section 23 and section 24 the <i>IFRS for SMEs</i> Standard; IPSAS 9 <i>Revenue from Exchange Transactions</i> ; IPSAS 23 <i>Revenue from Non-exchange Transactions (Taxes and Transfers)</i> . | FRS 102 Section 24 <i>Government Grants</i> , FRS 102 Section 34 <i>Incoming Resources from Non-exchange Transactions</i> , Charities SORP (FRS 102) (Second Edition) Section 5 <i>Recognition of income, including legacies, grants and contract income</i> . | AASB 15 <i>Revenue from Contracts with Customers</i> ; AASB 1058 <i>Income of Not-For-Profit Entities</i> | PBE IPSAS 9 <i>Revenue from Exchange Transactions</i> ; PBE IPSAS 23 <i>Revenue from Non-Exchange Transactions</i> for Tier 1 and 2 entities; PBE SFR A NFP, <i>Public Benefit Entity Simple Format Reporting – Accrual (Not-for-Profit)</i> for Tier 3 entities. | CPA Canada Handbook - Accounting, Section 4410, <i>Contributions – revenue recognition</i> ; CPA Canada Public Sector Accounting Handbook, PS 4210, <i>Contributions – revenue recognition</i> . | Accounting Standards Codification (ASC) 958-605. |

Issue 4 – Grant expenses

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|--|---|---|--------------------------------|---|--|--|
| <p>Alternative 1</p> <p>Follow international standards (either IFRS Standards, the <i>IFRS for SMEs</i> Standard or IPSAS) and include additional guidance on recognition, measurement and disclosure including performance related conditions.</p> | <p>IFRS Standards and IPSAS and the <i>IFRS for SMEs</i> Standard require a liability and an expense for a grant to be recognised when a grantor has a present obligation to fund another entity/ individual created by a past event.</p> | <p>The UK position generally follows IFRS Standards but includes specific provisions on performance obligations and disclosure. FRS 102 includes the requirement to provide separate disclosures for recognised and unrecognised commitments.</p> <p>The Charities SORP provides more detailed examples of practical application. Disclosures of any unrestricted funds designated to fund future commitments is also required.</p> | <p>Follows IFRS Standards.</p> | <p>Follows IPSAS for Tier 1 and Tier 2 entities. Additional illustrative guidance is also provided.</p> | <p>Accounting standards on the recognition of provisions etc. are similar to international requirements but there is no specific guidance on accounting for grant expenditure.</p> | <p>A liability would be recognised when the grant/promise is unconditional. Conditional grants/ promises would be disclosed only. This is unless an asset has actually been transferred, in which case the NFP would record an asset (advance receivable) until the conditions are met. Note that since the guidance parallels that for the recipient side of the transaction, and there is thus much cross-reference to those provisions.</p> |

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|--|---|--|--|---|--------|---|
| Alternative 2 Follow either IFRS Standards, the <i>IFRS for SMEs</i> Standard or IPSAS, include additional guidance on recognition, measurement incorporating the performance obligation approaches proposed in ED72 by IPSAS, when IPSAS is not used as the base. | As above | | | For Tier 3 PBE Simple Format Reporting – Accrual (Not-for-profit) Standard includes requirements/ guidance for accounting for grant expenses. | | |
| Standards references | IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i> IPSAS 19 <i>Provisions, Contingent Liabilities and Contingent Assets</i> , the <i>IFRS for SMEs Standard, Section 21. IAS 1 & IPSAS 1 Presentation of Financial Statements. The IFRS for SMEs Standard sections 3 and 5</i> | FRS 102 paragraphs 34.57 to 34.63 and Appendix A to Section 34 and Charities SORP paragraphs 7.5 to 7.34 and 7.43 to 7.46. | AASB 137 <i>Provisions, Contingent Liabilities and Contingent Assets</i> . | PBE IPSAS 19 <i>Provisions, Contingent Liabilities and Contingent Assets</i> . | | FASB ASC 958-720 Not-for-Profit Entities Other Expenses, 958-405 Not-for-Profit Liabilities, 958-405-45 Other Presentation Matters, and 958-405-50 Disclosure (including glossary entries). |

Issue 5 – Measurement of assets held for their service benefit

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|---|--|----|--|-------------|--------|-----|
| <p>Alternative 1 Subsequent measurement of property plant and equipment follows either the cost model or the revaluation model, with additional NPO-specific guidance.</p> | <p>Initial recognition measured at historical cost.</p> <p>Subsequent measurement for property plant and equipment: entities are allowed to choose between the cost and the revaluation models.</p> <p>If the recoverable amount of an asset is less than its carrying amount, an entity is required to reduce the carrying amount of the asset to its recoverable amount. (IFRS Standards and IPSAS set out that an asset is impaired when the carrying amount exceeds its recoverable amount).</p> | | <p>Initial recognition measurement at historical cost. (Not for profit entities are required to measure at fair value if consideration is significantly less than fair value.)</p> <p>Subsequent measurement for property plant and equipment: entities are allowed to choose between the cost and the revaluation models.</p> <p>Exchanges of assets measured at fair value unless the exchange transaction lacks commercial substance or is not measurable.</p> <p>An impairment loss is the amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount.</p> | | | |

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|--|--------------------------|---|-----------|--|--------|-----|
| Alternative 2 Subsequent measurement of property plant and equipment follows either the cost model or the revaluation model and includes an additional measurement base (value in use) under the revaluation model – with additional NPO-specific guidance on how to measure the service potential in those assets to be measured at ‘value in use’. | | <p>Initial recognition at historical cost.</p> <p>Subsequent measurement for property plant and equipment: entities are allowed to choose between the cost and the revaluation models.</p> <p>Exchanges of assets measured at fair value unless exchange is not at commercial or measurable.</p> <p>Impairment – If the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset must be reduced to its recoverable amount.</p> <p>Where an asset is held for its service potential FRS 102 recognises that a cash flow driven valuation may not be appropriate.</p> <p>Charities SORP provides practical guidance on the measurement of the recoverable amount when the asset is not income generating.</p> | | <p>Initial recognition at historical cost.</p> <p>Subsequent measurement for property plant and equipment: entities are allowed to choose between the cost and the revaluation models.</p> <p>Where an asset is acquired through a non-exchange transaction, its cost must be measured at its fair value as at the date of acquisition.</p> <p>An asset is impaired when its carrying amount exceeds its recoverable amount.</p> | | |

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|---|--------------------------|----|-----------|-------------|--|---|
| Alternative 3 Subsequent measurement of property plant and equipment using the cost model - with additional NPO-specific guidance. | | | | | <p>Property, plant and equipment is required to be recorded at cost.</p> <p>Amortisation must be recognised in a rational and systematic manner appropriate to the nature of the item and its use by the organisation.</p> <p>For contributed capital assets, cost is considered to be fair value at the date of contribution. In unusual circumstances when fair value cannot be reasonably determined, the tangible capital asset should be recorded at nominal value.</p> | <p>Purchased capital assets recognised at historical cost.</p> <p>The revaluation model is not permitted for subsequent measurement.</p> <p>Impairment follows the same accounting treatment as commercial entities (and is similar to IFRS). It discusses how contribution subsidies would be factored into a cash-flow focused test.</p> <p>Contributed assets are measured at fair value on initial recognition.</p> |

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|---|--|---|--|--|--|--|
| Alternative 4 Require certain classes of assets where they are used for their service potential to be measured using the revaluation model at a 'value in use' measurement basis. For the remaining classes of assets (plant and equipment) allow a rebuttable presumption that assets measured at historical cost is a proxy for the revalued asset. | | The Government Financial Reporting Manual provides guidance on the accounting for assets and liabilities. The valuation of property, plant and equipment is covered in 10.1.1 to 10.1.14. | | | | |
| Standards references | IAS 16 <i>Property, Plant and Equipment</i> , IAS 36 <i>Impairment of Assets</i> The <i>IFRS for SMEs</i> Standard sections 17 and 27. IPSAS 17 <i>Property, Plant and Equipment</i> IPSAS 24 <i>Impairment of Non-Cash Generating Assets</i> . IPSAS 36 <i>Impairment of Cash Generating Assets</i> . | FRS 102 sections, 17 and 27. Charities SORP (FRS 102) Module 12 Government Financial Reporting Manual (20-21) Chapter 10. | AASB 116 <i>Property, Plant and Equipment</i> , AASB 136 <i>Impairment of Assets</i> . | PBE IPSAS 17 <i>Property, Plant and Equipment</i> , PBE IPSAS 21 <i>Impairment of Non-Cash Generating Assets</i> . PBE IPSAS 26 <i>Impairment of Cash Generating Assets</i> . | CPA Canada Handbook – Accounting: Section 4433 and Section 3061. | ASC 835-20-05-1, 835-20-30, 958-605-30-1 to 2, 958-360-30-1, 958-360-35-8. |

Issue 6 – Inventory held for use or distribution

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|--|--|----|-----------|-------------|---|---|
| <p>Alternative 1</p> <p>Measure all inventory at the lower of cost or net realisable value with additional NPO-specific guidance.</p> | <p>IAS 2 and Section 13 of the <i>IFRS for SMEs</i> Standard include requirements for accounting for inventory.</p> | | | | | <p><i>Although the US standards are not based on international standards, the requirements are similar, and the US standards do not provide any exceptions to the general principles.</i></p> <p>There is no specific guidance applicable to not-for-profit entities.</p> |
| <p>Alternative 2</p> <p>Require inventory held for use or distribution to be measured at the lower of cost or current replacement cost.</p> | <p>IPSAS 12 includes requirements for accounting for inventory, including a requirement that inventory held for use or distribution is measured at the lower of cost and current replacement cost. IPSAS 12 does not apply to work-in-progress of services to be provided at no or nominal cost.</p> | | | | <p>Sections 3031 and 3032 include requirements for accounting for inventory, including a requirement that inventory held for use or distribution is measured at the lower of cost and current replacement cost.</p> | |

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|--|--|---|---|---|---|--|
| <p>Alternative 3</p> <p>Require inventory held for use or distribution to be measured at cost, adjusted when applicable for any loss of service potential, with disclosure of the accounting policy and impact on service delivery.</p> | | FRS 102 Section 13 includes requirements for accounting for inventory, including a requirement that inventory held for use or distribution is measured at the lower of cost, adjusted when applicable for any loss of service potential and replacement cost. | AASB 102 includes requirements for accounting for inventory, including a requirement that inventory held for use or distribution is measured at cost, adjusted when applicable for any loss of service potential; or at current replacement cost when acquired in a non-exchange transaction. AASB 102 allows work-in-progress of services provided at no or nominal cost to be expensed. | PBE IPSAS 12 includes requirements for accounting for inventory, including a requirement that inventory held for use or distribution is measured at cost, adjusted when applicable for any loss of service potential. PBE IPSAS 12 does not apply to work-in-progress of services to be provided at no or nominal cost. | | |
| Standards references | IAS 2 <i>Inventories</i> , Section 13 the <i>IFRS for SMEs</i> Standard, IPSAS 12 <i>Inventories</i> . | FRS 102 Section 13 <i>Inventories</i> Charities SORP Module 6 <i>Donated goods, facilities and services, including volunteers</i> ; Module 10 <i>B1</i> . | AASB 102 <i>Inventories</i> . | PBE IPSAS 12 <i>Inventories</i> . | CPA Canada Handbook - Accounting, Sections 3031 <i>Inventories</i> and 3032 <i>Inventories held by not-for-profit organizations</i> . | Accounting Standards Codification (ASC) 330-10 (Inventories-Overall), 330-10-15-3-a (Scope and Scope Exceptions-Entities). |

Issue 7 – Financial statement presentation

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|--|--|---|--|---|--|-----|
| <p>Alternative 1</p> <p>Use existing international standards (IFRS standards, the <i>IFRS for SMEs</i> Standard or IPSAS) with additional NPO-specific guidance on the provision of additional information to meet stakeholder needs.</p> | <p>IFRS Standards, the <i>IFRS for SMEs</i> Standard and IPSAS require the presentation of an income statement (statement of financial performance); a statement of financial position (balance sheet); cash flow statement; and statement of changes in net assets or equity.</p> | <p>FRS 102 requires the presentation of an income statement (statement of financial performance); a statement of financial position (balance sheet); cash flow statement; and statement of changes in net assets or equity.</p> | <p>AASB 101 and AASB 107 require the presentation of an income statement (statement of financial performance); a statement of financial position (balance sheet); cash flow statement; and statement of changes in net assets or equity.</p> | <p>PBE IPSAS 1, PBE IPSAS 2 and PBE SFR A NFP require the presentation of an income statement (statement of financial performance); a statement of financial position (balance sheet); cash flow statement; and statement of changes in net assets or equity (not PBE SFR A NFP).</p> <p>PBE SFR A NFP provides guidance on types of reserve.</p> | <p><i>Canadian standards are similar to international standards.</i></p> <p>CPA Handbook – Section 4400 and Public Sector Accounting Handbook, PS 4200 permit, but do not require, the use of fund accounting.</p> <p>A statement of changes in net assets is required.</p> <p>The different classes of net assets to be presented are: endowments; internally and externally (other than endowments); restricted net assets; and unrestricted net assets.</p> | |

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|--|--------------------------|--|-----------|-------------|--------|--|
| <p>Alternative 2</p> <p>Use the <i>IFRS for SMEs</i> Standard and require NPOs to use fund accounting and disclosure of reserves policy in the preparation of the financial statements, with guidance on additional information to meet stakeholder needs.</p> | | <p>Sector specific guidance (Charities SORP) requires the use of fund accounts for NPOs. A columnar approach is required in the income statement and permitted, but not required, in the statement of financial position. Funds presented separately are unrestricted funds, restricted income funds and restricted endowment funds.</p> | | | | <p>ASC 958-205, 958-210, 958-220, 958-225 and 958-230 require restricted net assets and unrestricted net assets to be presented separately. Income is reported as either restricted or unrestricted. Expenditure is shown as unrestricted. As restrictions imposed by the donor are satisfied, net assets are reclassified from restricted to unrestricted to match the expenditure.</p> |
| <p>Alternative 3</p> <p>Use the <i>IFRS for SMEs</i> Standard and require NPOs to use fund accounting in the preparation of the financial statements, disclosure of reserves policy and in addition prepare supplementary fund/project statements for material fund/projects.</p> | | | | | | |

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|-----------------------------|---|--|---|--|---|---|
| Standards references | IAS 1 <i>Presentation of Financial Statements</i> IAS 7 <i>Statement of Cash Flows</i> . Sections 3 – 8 the <i>IFRS for SMEs</i> Standard IPSAS 1 <i>Presentation of Financial Statements</i> IPSAS 2 <i>Cash Flow Statements</i> . | Sections 3 – 8 <i>FRS 102</i> Charities SORP (FRS 102) (Second Edition) Modules 2, 4, 10 and 14. | AASB 101 <i>Presentation of Financial Statements</i> . AASB 107 <i>Statement of Cash Flows</i> . | PBE IPSAS 1 <i>Presentation of Financial Statements</i> and PBE IPSAS 2 <i>Statement of Cash Flows</i> for Tier 1 and Tier 2 entities PBE SFR A NFP, <i>Public Benefit Entity Simple Format Reporting – Accrual (Not-for-Profit)</i> for Tier 3 entities. | CPA Handbook – Accounting, Section 4400 <i>Financial statement presentation by not-for-profit organizations</i> and Public Sector Handbook, PS 4200 <i>Financial statement presentation by not-for-profit organizations</i> . | ASC 958-205 <i>Presentation of Financial Statements</i> 958-210 <i>Balance Sheet</i> 958-220 <i>Income Statement – Reporting Comprehensive Income</i> 958-225 <i>Income Statement</i> 958-230 <i>Statement of Cash Flows</i> . |

Issue 8 – Classification of expenses

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA | Colombia |
|---|--|---|--|---|--|-----|-----------------------------------|
| Alternative 1 Allow analysis by function or nature of expense. | IFRS Standards, the <i>IFRS for SMEs</i> Standard and IPSAS, require an analysis of expenses based on either their nature or their function, whichever provides information that is reliable and more relevant. IAS 1 ⁶⁰ and IPSAS 1 permit this information to be reported either on the face of the primary statement or in the notes. | Smaller charities are allowed the alternative to provide a nature of expense analysis. | NPOs are required to present an analysis of expenses using a classification based on either their nature or their function, whichever provides information that is reliable and more relevant. | An entity is required to present, either on the face of the primary statement or in the notes, an analysis of expenses using a classification based on either the nature of expenses or their function within the entity, whichever provides information that is faithfully representative and more relevant. | NFPOs may present expenses in the statement of operations by nature, function or program. Expenses should be presented in the manner that results in the most meaningful presentation. | | In accordance with IFRS for SMEs. |
| Alternative 2 Require analysis of expenses on by nature or require analysis of expenses by function | | Further and Higher Education SORP requires a nature of expenses analysis. UK GAAP for Charities requires an analysis by activity. | | | | | |

⁶⁰ The current consultation will require that the primary analysis chosen is shown on the face of the financial performance standard, which underpins alternative 2.

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA | Colombia |
|--|--|---|---|---|--|---|----------|
| Alternative 3 Require analysis on both a function of expense and nature of expense analysis. | | | | | | NFPs are required to present or disclose their expenses by both functional and natural classification in one location in the financial statements or notes. | |
| Alternative 4 Hybrid expense analysis, which sets out minimum reporting categories | | | | Tier 3 (smaller entities) are required to report against minimum expense categories that are a hybrid of nature and function. | | | |
| Standards references | IAS 1 <i>Presentation of Financial Statements</i> , Paragraph, the <i>IFRS for SMEs</i> Standard paragraph 5.11 and IPSAS 1 <i>Presentation of Financial statements</i> paragraph 109. | FRS 102 <i>The Financial Reporting Standard applicable in the UK and Republic of Ireland</i> paragraph 5.5 Charities SORP (FRS 102) (Second Edition Section 4). HEFE SORP | AASB 101, <i>Presentation of Financial Statements</i> paragraph 99. | PBE IPSAS 1 <i>Presentation of Financial Statements</i> , paragraph 109 | Reference- CPA Canada Handbook – Accounting: Section 4400, Section 4470, and CPA Canada Public Sector Accounting Handbook: PS 4200, and PS 4270. | FASB ASC 958-205-45-1 to 6 and definitions ASC 958-205-20 | |

Issue 9 – Fundraising costs

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|--|---|----|---------------------------------------|---|---------------------------------------|-----|
| <p>Alternative 1</p> <p>Follow existing international guidance on the recognition, presentation and disclosure of expenses with NPOs deciding whether the resulting information is reliable and relevant to its users of the financial statements. Additional guidance will support NPOs.</p> | <p>IAS 1 and IPSAS 1 allow entities to determine their own definitions of function and similarly IFRS 8 IPSAS 18 allow entities to define their operating segments.</p> | | <p>No specific guidance provided.</p> | <p>No specific guidance provided for tier 1 and tier 2 entities with additional guidance for tier 3 entities on the recognition of spend.</p> | <p>No specific guidance provided.</p> | |
| <p>Alternative 2</p> <p>Follow existing international guidance on the recognition, presentation and disclosure of expenses with NPOs deciding whether the resulting information is reliable and relevant to its users of the financial statements. Require the disclosure of the accounting policy on fundraising costs only if such costs are disclosed or presented in the financial statements. Additional guidance will support NPOs.</p> | | | | | | |

| | IFRS Standards and IPSAS | UK | Australia | New Zealand | Canada | USA |
|--|--|--|-----------|--|--------|--|
| <p>Alternative 3</p> <p>Develop new NPO-specific guidance that requires disclosure of the amount and accounting policy for fundraising costs.</p> | | <p>Netting off is not permitted.</p> <p>The Charities SORP requires expenditure on raising funds to be presented separately as part of the functional analysis of costs. The Charities SORP provides further guidance in on what constitutes expenditure on raising funds. Further disaggregation between different types of raising funds is permitted.</p> | | | | <p>Netting off is permitted for activities that are direct donor benefits (eg cost of meals, gifts etc) associated with special events such as fundraising galas.</p> <p>Guidance on the allocation of overheads to functions is provided.</p> |
| Standards references | <p>IAS 1 <i>Presentation of Financial Statements</i>, Paragraph, the <i>IFRS for SMEs</i> Standard paragraph 5.11 and IPSAS 1 <i>Presentation of Financial statements</i> paragraph 109.</p> <p>IFRS 8 <i>Operating Segments</i> and IPSAS 18 <i>Segment Reporting</i></p> | <p>para 2.52 of FRS 102. paragraphs 4.44 to 4.51 of the Charities SORP.</p> | | <p>Section A.80 PBE SFR-A (NFP)</p> <p>https://www.xrb.govt.nz/accounting-standards/not-for-profit/pbe-sfr-a-nfp/</p> | | <p>FASB ASC 958-720 Not for Profit Entities Other expenses. Specific references 958-720-05-5, 958-720-25-section 4 and 5, 958-720-45-2 and 958-720-45-9</p> |

Issue 10 – Narrative reporting

| | IFRS Standards and IPSAS | IIRC | UK | Australia | New Zealand | Canada | USA |
|--|--|------|---|---|---|---|--|
| <p>Alternative 1</p> <p>'Do nothing' Leave organisations/ jurisdictions to follow existing guidance on narrative reporting by NPOs.</p> | | | | <p>No specific guidance provided.</p> <p>At federal level, charities provide a regulatory return (Annual Information Statement, AIS) to the Australian Charities and Not-for-profits Commission (ACNC).</p> | | <p>No specific guidance provided.</p> <p>At federal level, registered charities must file a Registered Charity Information Return with the Canada Revenue Agency (CRA).</p> | <p>No specific guidance provided.</p> <p>At federal level, the Internal Revenue Service (IRSP) form requires information on program accomplishments.</p> |
| <p>Alternative 2</p> <p>Apply existing international guidance on narrative reporting, tailored as appropriate for reporting in the NPO context.</p> | <p>IFRS Practice Statement <i>Management commentary</i> is described as a narrative report that provides a context within which to interpret the financial position, financial performance and cash flows of an entity. It also provides an opportunity to explain objectives and its strategies for achieving those objectives. IPSAS RPGs.</p> | | <p>The Charities SORP specifies that the report, taken together with the accounts, should provide a picture of what the charity has done (its outputs) or achieved (its outcomes), or what difference it has made (its impact). It requires, among other things, information about a charity's objectives, activities achievements and performance.</p> | | <p>Large NPOs with public accountability (Tier 1), plus NPOs that have total expenses greater than NZ\$2 million but less than NZ\$30 million are required to provide, contextual information about the entity, what it intends to achieve over the medium to long term, and how, plus information about achievements in working towards its broader aims and objectives.</p> | | |

| | IFRS Standards and IPSAS | IIRC | UK | Australia | New Zealand | Canada | USA |
|---|--------------------------|--|----|-----------|-------------|--------|-----|
| Alternative 3 Apply integrated reporting, following the IIRC Framework, tailored as appropriate for reporting in the NPO context. | | As well as information on the six capitals referred to in paragraph 3.7, the <IR> Framework specifies a number of content elements: a. Organisational overview and external environment; b. Governance; c. Business model; d. Risks and opportunities; e. Strategy and resource allocation; f. Performance; g. Outlook. | | | | | |

| | IFRS Standards and IPSAS | IIRC | UK | Australia | New Zealand | Canada | USA |
|---|---|--|---|---|--|--------|-----|
| Standards/ guidance references | IFRS Practice Statement (2010) <i>Management Commentary</i> . IPSAB Recommended Practice Guidance (RPG) 2 (2013) <i>Financial Statement Discussion and Analysis</i> ; RPG 3 (2015) <i>Reporting Service Performance Information</i> . See paragraph 3.3. | IIRC <i>The International <IR> Framework</i> (2013). | Charities SORP (FRS 102) (Second Edition, October 2019) <i>Accounting and reporting by charities: the statement of recommended practice (SORP)</i> . See chapter 1 <i>Trustees' annual report</i> . | No specific guidance but the Australian Accounting Standards Board (AASB) has project plans for both management commentary and service performance information. | Public Benefit Entity (PBE) Financial Reporting Standard (FRS) 48 <i>Service Reporting Performance</i> . | | |



INTERNATIONAL FINANCIAL REPORTING
FOR NON PROFIT ORGANISATIONS

Analysis of NPO- specific issues against international standards

Analysis of NPO-specific issues against international standards

The Guidance being developed will be a single document covering a range of specific financial reporting issues. The sector specific issues, developed from a number of independent sources, are examined in more detail in Part 2 of this Consultation Paper. Further information about how the list of issues included in the Consultation Paper have been derived is in Supplementary Information: Additional Project Information and in Part 2: Overview.

The specific issues identified have been grouped into five main categories:

- Reporting entity
- Accounting for incoming resources
- Accounting for outgoing resources
- Accounting for financial and non-financial assets
- Presentation, scope and content of financial reports.

These are set out below along with a description of some of the main sector specific issues relevant to each category. Against each of issues there is a high-level assessment that provides an indication of the applicability of existing standards under full IFRS Standards, the *IFRS for SMEs* Standard and IPSAS. The purpose of the analysis is to provide an indication of the extent to which current international standards address NPO-specific issues. This assessment is not an exhaustive analysis of the issues and should not be relied on as a formal interpretation of the standards.

The following key is in use for the table:

| Applicability of existing standards to specific NPO reporting issue | Rating |
|--|--------|
| The framework is silent on the issues or provides guidance that is largely not applicable in the NPO context | |
| The framework provides some guidance that could be utilised in the NPO context but does not specifically address NPO issues and requires the use of judgement in applying the guidance that exists | |
| The framework provides a range of guidance that appears to be directly applicable in the NPO context and to the specific issues | |

| Topic | Issues | IFRS Standards | The <i>IFRS for SMEs</i> Standard | IPSAS |
|---|---|--|--|---|
| Reporting entity | | | | |
| Definition of reporting entity (including the treatment of branches) | <p>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?</p> <p>How is control defined (as NPOs may not be exposed to investee returns in a conventional sense)?</p> | <p>IFRS 10 <i>Consolidated Financial Statements</i> provides a definition of control that focuses on exposure or rights to variable returns from involvement with an investee and the ability to affect those returns through power over the investee.</p> <p>The <i>Conceptual Framework</i> notes that a reporting entity can be a single entity or a portion of an entity or can comprise more than one entity. A reporting entity is not necessarily a legal entity.</p> | <p>The <i>IFRS for SMEs</i> Standard in Section 9 <i>Consolidated and Separate Financial Statements</i> provides guidance on control that focuses on the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.</p> | <p>IPSAS 35 <i>Consolidated Financial Statements</i> provides a definition of control that focuses on exposure or rights to variable benefits.</p> <p>The <i>Conceptual Framework</i> notes that a reporting entity may be an organisation, program, or identifiable area of activity. A reporting entity may have a separate legal identity or be an organisation, administrative arrangement, or program without a separate legal identity.</p> |
| | | | | |

| Topic | Issues | IFRS Standards | The <i>IFRS for SMEs</i> Standard | IPSAS |
|-----------------------------|---|---|---|---|
| Reporting entity | | | | |
| Agency relationships | When is an NPO acting as an agent and when is it acting as principal? | IFRS 15 <i>Revenue from Contracts with Customers</i> provides guidance on determining whether an entity is a principal or agent in relation to the provision of goods or services to a customer in relation to revenue recognition. | The <i>IFRS for SMEs</i> Standard has not yet been updated to reflect the principles of IFRS 15, but Section 23 <i>Revenue</i> also requires an entity to only recognise commission as revenue if it is acting as an agent. | IPSAS 9 <i>Revenue from Exchange Transactions</i> provides guidance on determining whether an entity is a principal or agent in relation to the provision of goods or services to a customer in relation to revenue recognition. |
| | | | | |
| | 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)? | There is no specific guidance on recognition of accounting for expenditure in agency relationships. <i>IAS 7 Statement of Cash Flows</i> permits cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity to be reported on a net basis rather than a gross basis. | There is no specific guidance on recognition of accounting for expenditure in agency relationships. | There is no specific guidance on recognition of accounting for expenditure in agency relationships. <i>IPSAS 2 Cash Flow Statements</i> permits cash receipts collected and payments made on behalf of customers, taxpayers, or beneficiaries when the cash flows reflect the activities of the other party rather than those of the entity to be reported on a net basis rather than a gross basis. |
| | | | | |

| Topic | Issues | IFRS Standards | The <i>IFRS for SMEs</i> Standard | IPSAS |
|--|---|--|--|---|
| Reporting entity | | | | |
| Mergers and acquisitions (combinations) | What is the accounting treatment for the combination of two or more NPOs? Should merger accounting be permitted/ required? If the acquisition method is required what is the accounting for a gain/ negative goodwill? | IFRS 3 <i>Business Combinations</i> provides guidance in determining whether a transaction or other event is a business combination and requires the acquisition method to be applied so that the acquirer recognises assets acquired and liabilities assumed. It also addresses accounting for goodwill and gains (bargain purchases or negative goodwill). | The <i>IFRS for SMEs</i> Standard Section 19 <i>Business Combinations and Goodwill</i> provides guidance on identifying an acquirer, measuring the cost of the business combination and allocating the cost to the assets acquired and liabilities assumed. It also addresses accounting for goodwill and gains (bargain purchases or negative goodwill). | IPSAS 40 <i>Public Sector Combinations</i> provides accounting guidance on public sector combinations based on classification as either an amalgamation or an acquisition. Where acquisition accounting is required, this addresses accounting for goodwill and gains (bargain purchases or negative goodwill). |
| | | | | |
| Intragroup transactions | When is income from a subsidiary recognised in the parent NPO's accounts taking account of legal considerations relating to the way in which the profits of a subsidiary are given to a parent? What disclosure should be required by both sides of the relationship/transaction when a branch is part of a larger NPO or an NPO is part of a group? | IFRS 10 <i>Consolidated Financial Statements</i> provides guidance on the treatment of intragroup balances and transactions in consolidated statements, including requirements to eliminate. IFRS 12 <i>Disclosure of Interests in Other Entities</i> provides guidance on disclosures (including restrictions on an entity's ability to access or use the assets and settle the liabilities of the group). | The <i>IFRS for SMEs</i> Standard in Section 9 <i>Consolidated and Separate Financial Statements</i> provides guidance on the treatment of intragroup balances and transactions in consolidated statements, including requirements to eliminate. Section 9 also provides guidance on disclosures (including restrictions on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends or to repay loans) and on the preparation of separate financial statements. | IPSAS 35 <i>Consolidated Financial Statements</i> provides guidance on the treatment of intragroup balances and transactions in consolidated statements, including requirements to eliminate. IPSAS 38 <i>Disclosure of Interests in Other Entities</i> provides guidance on disclosures (including restrictions on an entity's ability to access or use the assets and settle the liabilities of the economic entity). IPSAS 34 <i>Separate Financial Statements</i> provides guidance on the preparation of separate financial statements |
| | | | | |

| Topic | Issues | IFRS Standards | The IFRS for SMEs Standard | IPSAS |
|--|---|---|--|--|
| Accounting for incoming resources | | | | |
| Recognition and measurement of incoming resources from external sources | What are the overarching principles for the recognition and measurement of incoming resources from 'non-exchange' transactions, (of which donations, grants, services in-kind income are all categories)? | IAS 20 <i>Accounting for Government Grants and Disclosure of Government Assistance</i> provides recognition, measurement and disclosure requirements for income from government grants. | Section 24 <i>Government Grants</i> provides guidance on accounting for revenue from government grants. | IPSAS 23 <i>Revenue from Non-exchange Transactions (Taxes and Transfers)</i> provides guidance on the recognition and measurement of revenue from non-exchange transactions. An exposure draft ED 71 <i>Revenue without Performance Obligations</i> was released in February 2020 and will provide revised guidance once it becomes a full standard. |
| | Is there anything NPO-specific regarding exchange transactions (eg provision of services to third parties)? | For revenue from exchange transactions IFRS 15 <i>Revenue from Contracts with Customers</i> establishes principles for reporting on the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. | It has also not yet been updated to reflect the principles of IFRS 15, but Section 23 <i>Revenue</i> covers accounting for revenue arising from the sale of goods, rendering of services, construction contracts and the use by others of entity assets yielding interest, royalties or dividends. | IPSAS 9 <i>Revenue from Exchange Transactions</i> covers accounting for revenue arising from the sale of goods, rendering of services, and the use by others of entity assets yielding interest, royalties, and dividends or similar distributions. IPSAS 11 <i>Construction Contracts</i> covers accounting for revenue from construction contracts. An exposure draft ED 70 <i>Revenue with Performance Obligations</i> was released in February 2020 and will provide revised guidance once it becomes a full standard. |

| Topic | Issues | IFRS Standards | The IFRS for SMEs Standard | IPSAS |
|---|--|---|--|--|
| Accounting for incoming resources | | | | |
| Cash transfers – donations, grants and other contributions with time and purpose requirements and other criteria/performance obligations | Timing of income recognition and definition of performance criteria/obligation. What is the recognition and measurement process when receiving donations that are used to fulfil requirements (including a specific time and purpose requirement) in subsequent periods? | IAS 20 <i>Accounting for Government Grants and Disclosure of Government Assistance</i> provides recognition, measurement and disclosure requirements for income from government grants. | Section 24 <i>Government Grants</i> provides guidance on accounting for revenue from government grants. | IPSAS 23 <i>Revenue from Non-exchange Transactions (Taxes and Transfers)</i> provides guidance on present obligations which may give rise to a liability in respect of any non-exchange revenue. |
| | When should donations to purchase a capital asset be recognised? What if the donation is repayable if the asset, at some future date, is no longer used for its intended purpose? | | | |
| Services in-Kind (including volunteers) | When should services in-kind be recognised and if so how are they measured? What disclosures should be provided? | IFRS Standards provide no specific accounting guidance on the recognition of services in-kind. | The <i>IFRS for SMEs</i> Standard provides no specific accounting guidance on the recognition of services in-kind. | IPSAS 23 <i>Revenue from Non-exchange Transactions (Taxes and Transfers)</i> provides guidance on accounting for services-in-kind. |
| | Recognition and measurement of 'right of use' donations (including free use of space and equipment)? | | | It does not require recognition of services-in-kind but encourages disclosure. |

| Topic | Issues | IFRS Standards | The IFRS for SMEs Standard | IPSAS |
|---|--|--|---|--|
| Accounting for incoming resources | | | | |
| Gifts in-kind (non-financial assets and inventory) | When should gifts in-kind be recognised and how should they be measured, including low value items such as inventory (second-hand for sale and new for distribution as part of charitable activities)? | IAS 20 <i>Accounting for Government Grants and Disclosure of Government Assistance</i> provides guidance if received from a government entity. | Section 24 <i>Government Grants</i> provides guidance if received from a government entity. | IPSAS 23 <i>Revenue from Non-exchange Transactions (Taxes and Transfers)</i> provides guidance on accounting for Gifts and Donations, including Gifts-in-Kind. |
| | How should assets financed by capital grants be recognised and measured (ie gross or net), and the implications for the recognition of the grant in income? | | | |
| | How should assets that can only be used for a specific purpose and may have to be returned be measured initially and subsequently? | | | |

| Topic | Issues | IFRS Standards | The IFRS for SMEs Standard | IPSAS |
|---|---|--|--|--|
| Accounting for incoming resources | | | | |
| Recognition of legacy/ bequest income and endowments | <p>When should bequests be recognised? What are the considerations involved with perpetual trusts and/or a portfolio of similar smaller assets?</p> <p>How are endowments recognised and classified, including the treatment of the initial contribution, subsequent changes in the value of the initial contribution and treatment of income earned?</p> <p>How should income from endowments be presented in the operating statement and balance sheet? What disclosures should be required for any restrictions on the entity?</p> | <p>IFRS Standards provide no specific guidance on accounting for legacies and bequest income.</p> <p>IFRS Standards provide no specific guidance on accounting for endowments.</p> | <p>The <i>IFRS for SMEs</i> Standard provides no specific guidance on accounting for legacies and bequest income.</p> <p>The <i>IFRS for SMEs</i> Standard provides no specific guidance on accounting for endowments.</p> | <p>IPSAS 23 <i>Revenue from Non-exchange Transactions (Taxes and Transfers)</i> provides guidance on accounting for bequests, gifts and donations.</p> <p>IPSAS provides no specific guidance on accounting for endowments.</p> |
| Accounting for outgoing resources | | | | |
| Grant expenses | <p>Recognition and measurement of NPO 'non-exchange' transfers to individuals and other entities?</p> <p>When is a liability recognised (whether a grant or promise), particularly in a multi-year arrangement?</p> | <p>IFRS Standards provide no specific guidance for accounting for grant expenditure by an entity.</p> | <p>The <i>IFRS for SMEs</i> Standard provides no specific guidance for accounting for grant expenditure by an entity.</p> | <p>There is presently no specific IPSAS on non-exchange expenses related to grants.</p> <p>An exposure draft ED 72 <i>Transfer Expenses</i> was released in February 2020 and will provide guidance once it becomes a full standard.</p> |

| Topic | Issues | IFRS Standards | The IFRS for SMEs Standard | IPSAS |
|---|--|---|--|--|
| Accounting for financial and non-financial assets | | | | |
| Measurement of tangible and intangible assets held for their service potential | How should assets that are held for service potential be measured, both initially and subsequently? | IFRS Standards provide for initial recognition at cost but no specific guidance on the subsequent measurement of tangible and intangible assets held for their service potential. | The <i>IFRS for SMEs</i> Standard requires such assets to be held under a cost model or a revaluation model based on fair value with no specific guidance on the subsequent measurement for assets held for their service potential. | IPSAS 17 <i>Property, Plant and Equipment</i> , IPSAS 31 <i>Intangible Assets</i> , and IPSAS 21 <i>Impairment of Non-Cash Generating Assets</i> contain guidance on initial and subsequent measurement, including impairment, and disclosures for tangible and intangible assets. |
| | How do you identify impairment where assets are held for service potential (eg assets do not generate any income, or generate income at below market rate)? | | | |
| | When an impairment has been recognised, what disclosures should be made? | | | |
| Heritage assets and/or obligations | Recognition and measurement of heritage assets. | IFRS Standards provide no specific guidance on heritage assets. | The <i>IFRS for SMEs</i> Standard provides no specific guidance on heritage assets. | IPSAS 17 <i>Property, Plant and Equipment</i> and IPSAS 31 <i>Intangible Assets</i> provide limited guidance on accounting for heritage assets. Recognition of heritage assets is permitted but not required. |
| | What disclosures should be made about the nature and scale of heritage assets and acquisition, preservation etc. of the collection? | | | IPSASB released a consultation paper on accounting for heritage assets in 2017 and an exposure draft is currently being developed. There is presently, however, no standard. |
| | Recognition and measurement of significant heritage obligations, and any impact on the measurement of related assets? | | | |

| Topic | Issues | IFRS Standards | The IFRS for SMEs Standard | IPSAS |
|--|--|--|--|--|
| Accounting for financial and non-financial assets | | | | |
| Concessionary loans for social purposes | <p>What is the definition of a concessionary loan?</p> <p>What is the initial and subsequent measurement of special credit conditions?</p> <p>What is the treatment within a group if there is an inter-company loan with a for-profit entity?</p> <p>What disclosures should be made?</p> | <p>IFRS 9 <i>Financial Instruments</i> requires that when a loan is not on commercial terms it must be split into a 'below-market' element and a 'loan' element with the below-market element accounted for under the Conceptual Framework if no relevant standard exists.</p> | <p>The <i>IFRS for SMEs</i> Standard provides no specific guidance on concessionary loans.</p> | <p>IPSAS 23 <i>Revenue from Non-exchange Transactions (Taxes and Transfers)</i> provides guidance on recognising non-exchange revenue related to concessionary loans.</p> <p>IPSAS 41 <i>Financial Instruments</i> provides guidance on the recognition and measurement of concessionary loans and IPSAS 30 <i>Financial Instruments: Disclosures</i> provides guidance on concessionary loan disclosures.</p> |
| | | | | |
| Concessionary leases | <p>How should such arrangements be accounted for?</p> | <p>There is no specific guidance in IFRS Standards on accounting for concessionary leases.</p> | <p>There is no specific guidance in the <i>IFRS for SMEs</i> Standard on accounting for concessionary leases.</p> | <p>There is no specific guidance in IPSAS on accounting for concessionary leases.</p> |
| | | | | |
| Accounting for investment/ financial assets | <p>Classification, recognition and measurement requirements.</p> | <p>IFRS 9 <i>Financial Instruments</i> provides guidance for the classification, recognition and measurement of investments and other financial assets.</p> | <p>The <i>IFRS for SMEs</i> Standard provides guidance in Section 11 <i>Basic Financial Instruments</i> and Section 12 <i>Other Financial Instrument Issues</i>.</p> | <p>IPSAS 41 <i>Financial Instruments</i> provides guidance for the classification, recognition and measurement of investments and other financial assets.</p> |
| | | | | |

| Topic | Issues | IFRS Standards | The IFRS for SMEs Standard | IPSAS |
|--|--|--|--|--|
| Accounting for financial and non-financial assets | | | | |
| Service concessions arising in NPOs as grantor | When do these arise in the non-profit sector eg low income housing? What disclosures are required? | SIC 29 <i>Service Concession Arrangements: Disclosures</i> provides guidance on the disclosures to be made by grantors. | The <i>IFRS for SMEs</i> Standard provides no specific guidance on grantor accounting requirement in service concessions. | IPSAS 32 <i>Service Concession Arrangements: Grantor</i> provides guidance on accounting requirements of grantors in a service concession arrangement. |
| | | | | |
| Service concessions arising in NPOs as operator | When do these arise in the non-profit sector eg low income housing? What disclosures are required? | IFRIC® Interpretations 12 provides accounting guidance to the operator in a service concession arrangement. SIC 29 provides guidance on the disclosures to be made by an operator. | The <i>IFRS for SMEs</i> Standard provides accounting guidance for the operator in a service concession arrangement in Section 34, <i>Specialised Activities</i> . | IPSAS does not provide specific accounting guidance for the operator in a service concession arrangement. |
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| Inventory held for use or distribution | Should low value, high volume inventory, such as donated items for re-sale be recognised? How should donated inventory such as pharmaceuticals be measured if close to their 'use by date and potentially not usable? If inventory is impaired, how is the value of the impairment calculated? | IFRS Standards provide no specific guidance on donated inventory that is low value/ high volume or held for onward redistribution. | The <i>IFRS for SMEs</i> Standard provides no specific guidance on donated inventory that is low value/ high volume or held for onward redistribution. | IPSAS 12 requires that donated inventory is initially measured at fair value (this is discussed in the Revenue chapter). Inventory held for use or distribution is subsequently measured at the lower of cost and current replacement cost. IPSAS 12 does not apply to work-in-progress of services to be provided for no or nominal consideration. |
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| Topic | Issues | IFRS Standards | The IFRS for SMEs Standard | IPSAS |
|--|---|--|--|--|
| Form and content of financial reports | | | | |
| Financial statement presentation | <p>How should financial statements be presented to help the user understanding of an NPO's activities?</p> <p>Should there be disclosure of material categories of income and expenditure and/or transactions?</p> <p>How should unrestricted and restricted funds that can be used for specific NPO purposes be presented for the main financial statements and notes (including reserves)? How does this align with donor reporting requirements?</p> | IAS 1 <i>Presentation of Financial Statements</i> provides guidance on the reporting requirements for the presentation of financial statement and disclosure of material elements. | The <i>IFRS for SMEs</i> Standard Section 3 <i>Financial Statement Presentation</i> explains fair presentation of financial statements, what compliance with IFRS for SMEs requires and what a complete set of financial statements is. There are individual Sections providing requirements on: 4 <i>Statement of Financial Position</i> 5 <i>Statement of Comprehensive Income and Income Statement</i> 6 <i>Statement of Changes in Equity and Statement of Income and Retained Earnings</i> 7 <i>Statement of Cash Flows</i> | IPSAS 1 <i>Presentation of Financial Statements</i> provides guidance on the reporting requirements for the presentation of financial statements and disclosure of material elements. |
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| Categorisation of expenses – function or nature | <p>Should the primary analysis of expenses be based on function or nature of spend?</p> <p>What should the primary headings be?</p> | IAS 1 <i>Presentation of Financial Statements</i> requires that an entity presents, either on the face of the statement of financial performance or in the notes, an analysis of expenses using a classification based on either the nature of expenses or their function within the entity, whichever provides information that most reliable and relevant. | Section 5 of the <i>IFRS for SMEs</i> Standard requires that an entity present an analysis of expenses using a classification based on either the nature of expenses or the function of expenses within the entity, whichever provides information that is reliable and more relevant. | IPSAS 1 <i>Presentation of Financial Statements</i> requires that an entity presents, either on the face of the statement of financial performance or in the notes, an analysis of expenses using a classification based on either the nature of expenses or their function within the entity, whichever provides information that most reliable and relevant. |
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| Topic | Issues | IFRS Standards | The IFRS for SMEs Standard | IPSAS |
|---|--|--|--|---|
| Form and content of financial reports | | | | |
| Costs of fundraising | How should the costs of fund raising be defined (for example, whether to include business development spend and/or overheads)? | IFRS Standards provide no specific guidance on defining the costs of fundraising. | The <i>IFRS for SMEs</i> Standard provides no specific guidance on defining the costs of fundraising. | IPSAS provides no specific guidance on defining the costs of fundraising. |
| | How should the costs of fundraising be recognised and/or presented (ie on a gross basis or netted against income)? | | | |
| Narrative reporting, (including service reporting) | What should the narrative/non-financial reporting requirements be for NPOs? | IFRS Practice Statement 1 <i>Management Commentary</i> provides some key principles for management commentary, and additional guidance in areas including the nature of the business, objectives and strategies, resources, risks and relationships, results and prospects, and performance measures and indicators. | IFRS Practice Statement 1 <i>Management Commentary</i> is applicable to management commentary that relates to financial statements prepared in accordance with IFRS Standards. There is no reference to the <i>IFRS for SMEs</i> Standard. | Guidance on narrative reporting is contained within IPSAS Recommended Practice Guideline 1 <i>Reporting on the long term sustainability of an entity's finances</i> , Recommended Practice Guideline 2 <i>Financial Statement Discussion and Analysis</i> , and Recommended Practice Guideline 3 <i>Reporting Service Performance Information</i> . |
| | Should ratios be required for narrative reporting? If they are included, how should costs be classified been support costs and those attributable to operational delivery? | | | |

| Topic | Issues | IFRS Standards | The IFRS for SMEs Standard | IPSAS |
|--|--|--|---|--|
| Form and content of financial reports | | | | |
| Related party transactions | Definition, required disclosures and presentation of related party transactions. Implications of local legal requirements? | IAS 24 <i>Related Party Disclosures</i> provides guidance to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties. | The IFRS for SMEs Standard Section 33 <i>Related Party Disclosures</i> provides guidance to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties. | IPSAS 20 <i>Related Party Transactions</i> provides guidance on the disclosure of the existence of related party relationships where control exists, and the disclosure of information about transactions between the entity and its related parties in certain circumstances. |
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| Remuneration/pay disclosures | What disclosures should be made and who should be included? | IAS 24 <i>Related Party Disclosures</i> provides guidance on the disclosure of key management personnel compensation. | The <i>IFRS for SMEs</i> Standard Section 33 <i>Related Party Disclosures</i> provides guidance on the disclosure of key management personnel compensation. | IPSAS 20 <i>Related Party Transactions</i> provides guidance on the disclosure of the remuneration of key management personnel. |
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Glossary of terms

Glossary of terms

The purpose of the glossary is to provide a general meaning for terms used in Part 1 and Part 2 of the Consultation Paper as well as other resources related to the IFR4NPO project. This is to enable readers from all over the world have a common understanding of terms used and to be able to engage with the issues and questions raised. The terms used and explained in this glossary are not intended to be used as definitions, since many have specific meanings in different jurisdictions and in national and international accounting and other professional frameworks.

| Term | Plain English description |
|--------------------------------------|--|
| Accountability | The requirement to be answerable for policies, decisions and actions to external stakeholders. |
| Accountability arrangements | Arrangements put in place to enable an individual or entity be held accountable. |
| Accounting basis | The method used to determine when transactions are recognised in the accounts. It will either be cash, accruals, or modified cash. |
| Accounting standards | A set of common principles and procedures used for accounting. |
| Accrual based information | Recognition of a transaction in the accounts based on when the event to which it relates occurs rather than when cash is received or paid, eg expenditure on electricity would be recognised as electricity is used by an organisation and not only when the bill is paid. |
| Advisory groups | Groups established by the IFR4NPO project to review and comment on the development of project materials. Details of members can be found at www.ifr4npo.org . |
| Agency/principal relationship | When an entity acts on behalf of another entity it is an agent and is acting on behalf of the principal. The agent has no decision-making powers over the goods, assets or services provided by the principal to the end entity. |
| Asset | A resource that an individual or entity owns or controls as a result of a past event. |
| Assurance | An evaluation or measurement against set criteria that is designed to provide confidence over the item being evaluated. |
| Benefits | Outcomes that are advantageous to an organisation and/or its stakeholders. These can be of an economic, social, or environmental nature. |
| Business model | The way in which an organisation transforms its inputs into outputs and outcomes to achieve its purposes. |
| Cash | Cash is physical currency held by an entity and deposits available on demand. |
| Cash based information | Shows information that reflects when cash is paid or received. |
| Cash flow statement | Financial statement showing how cash has been received and used during a reporting period. |
| Conceptual framework | Describes the objectives and concepts used in developing accounting standards that enable general purpose financial reporting. |

| Term | Plain English description |
|--------------------------------|---|
| Concessionary loans | Loans that are granted on below market terms. |
| Condition | An event or activity specified by a resource provider that must occur for an entity to be entitled to utilise an asset provided to it. If this does not take place the asset must be returned to the resource provider. |
| Control | Control exists when an entity benefits from its involvement in and power over another entity or asset. |
| Country champion | Individuals appointed by the IFR4NPO project to assist the project team in engaging with individual jurisdictions. For details about the country champions go to www.ifr4npo.org . |
| Direct costs | Costs wholly and explicitly spent on a product, service or operational activity. |
| Disclosure | Additional information provided in the financial statements that provides further detail of amounts in the financial statements or provide the user with useful information. |
| Donors | Providers of cash or other resources to non-profit organisations without the expectation of anything of equal value to their direct benefit in return. |
| Donation | Cash or other resources provided to non-profit organisations without the expectation of anything of equal value to their direct benefit in return. |
| Economy | Minimising the cost of inputs while ensuring quality levels. |
| Effectiveness | The relationship between an organisation's results and service performance objectives. |
| Efficiency | How an organisation turns inputs into outputs/outcomes that shows the amount of inputs needed to produce outputs/outcomes. |
| Equity instrument | A contractual financial interest in the net assets of another entity, for example a shareholding. |
| Expenditure by function | Expenditure categorised by purpose or activity, eg education, sanitation, advocacy. |
| Expenditure by nature | Expenditure categorised by type of expenditure, eg employee costs, rent, etc. |
| Expense | Costs incurred by an entity. |
| External audit | An independent review of an organisation's financial statements carried out to give assurance to external stakeholders by licensed practitioners. |
| Fair value | The amount for which an asset, good or service could be sold to a third party in an arm's length transaction. |
| Financial assets | These are cash or equity instruments held or a contractual right to receive such items. Financial assets include items such as debtors and financial shares held by an entity in other entities. |
| Financial management | The system that an organisation has to plan, direct and control financial resources to achieve its purposes efficiently and effectively. |
| Funder | An organisation that provides the majority of the funding for a project, programme or NPO often in accordance with an agreement. |

| Term | Plain English description |
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| Fundraising costs | Sum of expenditure spent on fundraising activities to generate revenue, rather than on delivering goods and services for service users, or management and administration activities. |
| Generally Accepted Accounting Principles (GAAP) | A collection of commonly followed accounting rules and standards for financial reporting. |
| General Purpose Financial Reports (GPFRs) | A set of financial statements with narrative reports prepared under generally accepted accounting principles to provide information that is useful to users for accountability and decision-making purposes. |
| General Purpose Financial Statements (GPFS) | A set of financial statements prepared using generally accepted accounting principles. They comprise the statement of financial position (balance sheet), statement of financial performance (income statement), statement of changes in equity, and cash flow statement. They show what an entity owns, what it owes, its costs and revenues, and related cash flows. |
| Gifts in-kind | A physical item such as equipment and stock provided as a donation to an entity. |
| Good Financial Grant Practice (GFGP) Standard | A Standard developed by the African Academy of Sciences to standardise, simplify and strengthen the financial governance of grant funding. |
| Governance | Comprises the arrangements put in place to ensure that the intended outcomes for stakeholders are defined and achieved. |
| Governing body | The person(s) or group responsible for overseeing an organisation's overall activities, including strategic direction, operations and accountability. |
| Grant expense | Cash or assets (resources) provided by one entity as a result of a formal application for resources to another for a defined purpose. |
| Grant revenue | Cash or assets (resources) received by one entity as a result of a formal application for resources for a defined purpose. Access to the resources may depend on completing defined activities. Grant revenues do not result in a direct/personal benefit to the resource provider. |
| Gross basis | Expenses are presented in full and are not subtracted from any related revenue. |
| Heritage assets | Assets or collections held by an entity that are intended to be preserved in trust for future generations because of their cultural, environmental or historical associations. |
| Historical cost | The amount an item cost when it was bought or developed. |
| Impairment | A reduction in what an asset is worth or is able to produce as a result of changes in economic conditions or misuse. |
| Income statement | Alternative name for the statement that shows an entity's revenue and expenditure over a period. |
| Indirect costs | Costs that are not spent on a specific product, service or operational activity but apply to a number of activities, for example general administrative activities. |

| Term | Plain English description |
|---|---|
| Input(s) | Resources used to generate and deliver goods and services to achieve intended outcomes. |
| Intangible assets | Non-financial assets that do not have a physical form, eg software licenses. |
| Integrated report/ integrated reporting | Integrated reports explain how an organisation creates values over time by providing insight about the resources and relationships used and affected by an organisation. |
| Integrity | To display integrity, individuals should not act or take decisions to gain financial or other material benefits for themselves, their family, or their friends. |
| Internal control | Systems or processes in an organisation used to manage, measure and mitigate risks and report on them. |
| International Financial Reporting Standards (IFRS) | A set of accounting standards developed by the International Accounting Standards Board (IASB) for use by profit making private sector organisations internationally. |
| IFRS for SMEs Standard | A standalone standard developed by the International Accounting Standards Board (IASB) based on the principles in full IFRS Standards but tailored for entities that do not trade on a public market (eg a stock exchange). |
| International Public Sector Accounting Standards (IPSAS) | A set of accounting standards developed by the International Public Sector Accounting Standards Board (IPSASB) for use by government and public sector organisations internationally. |
| Jurisdiction | An administrative area where there are a set of laws and regulations under the control of a government. |
| Liability | An amount that an entity owes today resulting from something that happened in the past. |
| Management commentary | Additional information that is provided to supplement the financial statement information. |
| Market entities | Entities that charge economically significant prices for all or almost all of the goods and services they produce |
| Material/materiality | A matter is material if it could substantially affect the organisation's ability to show or create value in the short, medium or long term. |
| Measurement | The means to ascribe a monetary value to something that is recognised in the financial statements. |
| Modified cash-based information | Shows information where most transactions are included in the accounts when cash is received or paid, not when the event happened. Some assets and/or liabilities are also included in the financial information, at the discretion of each entity. |
| Money Where it Counts (MWiC) | An initiative intended to provide an international, harmonised and simplified approach to costing of projects and activities carried out by non-profit organisations. |
| Narrative reporting | Information provided about an organisation's objectives, strategies, and risks, and how it has used resources to achieve outcomes. |
| Net basis | Expenses are subtracted from any related revenue. |

| Term | Plain English description |
|----------------------------------|--|
| Net financial position | The difference between an entity's assets and liabilities. May sometimes also be referred to as net assets. |
| Non-exchange transactions | Where an organisation receives something of value from another party without having to directly provide something to them of equal value in return eg a donation of cash from an individual to a non-profit organisation can be used to provide services to others. |
| Non-financial assets | Assets that an entity controls like buildings or software that have service potential or can provide other economic benefits. Excludes financial assets such as cash and debtors. |
| Non-financial reporting | Additional information that is provided to supplement and complement the financial statement information. |
| Non-market entities | Entities that provide their outputs free or at economically insignificant prices. |
| Non-profit organisation | An entity that displays the following characteristics: <ul style="list-style-type: none"> • has the primary objective of delivering goods and/or services for the general public, community or social benefit • utilises any financial surpluses to further its primary objective • often has financially significant funding through donations and grants. |
| Outcome(s) | An organisation's impact on its service user or civil society as a result of its operations and its outputs. |
| Output(s) | The goods or services provided by an organisation. |
| Performance | An organisation's achievements relative to its purposes, strategic objectives and its outcomes. |
| Performance indicators | Quantitative or qualitative measures used to determine how an organisation is using its resources, providing services, and achieving its objectives. |
| Performance obligation | A promise to transfer to a customer a distinct good or service once conditions defined in an agreement have been fulfilled. |
| Present obligation | This arises where an organisation must settle amounts owed to individuals/entities in the future because of events that happened in the past. |
| Private corporations | Entities not controlled by governments. |
| Public benefit entity | An entity whose primary objective is to deliver goods and/or services for society rather than to make a profit. |
| Public corporations | Market entities controlled by governments. |
| Public interest | In relation to any action, decision, or policy made by an organisation the consideration of the impact on society. |
| Recognition | When items are included in an entity's financial statements at a monetary value. |
| Reporting date | The last day of the reporting period to which the financial statements relate. |
| Reporting entity | An individual organisation, programme or identifiable area of activity that prepares financial reports. |

| Term | Plain English description |
|--|--|
| Reporting period | The time between the start and end date of the period to which the financial statements relate, generally one year. |
| Reporting process | The people and activities involved in the preparation, review, approval, audit, analysis, and distribution of an organisation's reports. |
| Reserves | An entity's accumulated surpluses and often used to refer to general reserves which may be used for any purpose. Can also relate to amounts held for specific purposes defined by an organisation or that are restricted based on the original source of the revenue that generated the surplus. |
| Resource providers | Those that provide financial and other resources to an organisation. |
| Restriction | A limitation by a resource provider on the purposes to which an asset it has provided can be used. |
| Revenue | Incoming resources accounted for by an entity. |
| Risk | The effect of uncertainty on outcomes, which can be positive or negative. |
| Risk management | Coordinated activities to direct and control an organisation about risk. |
| Service delivery objectives | Objectives to deliver goods and/or services for the general public, community or social benefit and not to generate a financial return for resource providers. |
| Service performance reporting | A report that sets out the outcomes an entity seeks to achieve, what it actually achieved, and the goods and services provided during the reporting period. |
| Service potential | The capacity of an asset to provide services that contribute to achieving the entity's purposes and/or objectives. |
| Service users | Those reliant on the goods and services provided by an organisation. |
| Services-in-kind | Donations of time and/or services by individuals or organisations to an entity. |
| Stakeholder | Any person, group, or organisation that has an interest in an organisation's activities, resources, or output, or that is affected by that output. |
| Statement of changes in net assets/equity | Financial statement that shows changes in an entity's net assets. |
| Statement of comprehensive income | Financial statement that shows an entity's revenue and expenditure over a period in one section and an additional section that shows other changes from movements in reserves. |
| Statement of financial performance | Financial statement that shows an entity's revenue and expenditure over a period. |
| Statement of financial position | Financial statement that shows an entity's assets and liabilities at a point in time. |
| Stipulation | A limitation by a resource provider on the use of an asset that it has provided as a result of law, regulation or binding contract. |
| Strategy | Long-term, impact focused plan or policy. |
| Stewardship | Responsible planning, management, and accountability of the use and custody of an organisation's resources. |

| Term | Plain English description |
|---------------------------|---|
| Sustainability | The capacity of an organisation to meet its outcomes while living within its resource limits in the short, medium and long term. |
| Tangible assets | Non-financial assets that have physical form, eg property and equipment. |
| Transparency | Openness about the outcomes an organisation is pursuing, the way those outcomes are achieved, the resources necessary or used, and the performance achieved. |
| Useful information | Information that is relevant to users and faithfully represents what it purports to represent. The usefulness of information is enhanced if it is comparable, verifiable, timely, and understandable. |
| Value for money | Achieving value for money is often described in terms of economy, efficiency and effectiveness. |
| Value in use | The present value of an asset's remaining service potential (being the capacity of an asset to provide services that contribute to achieving the entity's purposes and/or objectives) or the estimated future cash flows derived from its use and disposal. |
| Voluntary Funding | Resources provided freely to an NPO without any expectation of anything directly in return as opposed to taxes which are a compulsory form of public funding. |



www.ifr4npo.org