

Technical Advisory Group Issue Paper

AGENDA ITEM: TAGCP08a-03

19 May 2020 – Online

Presentation of Financial Statements

Summary	The presentation of financial statements has been identified as a specific issue for non-profit organisations. This paper brings together material gathered from national and international standard setters.
Purpose/Objective of the paper	To allow TAG members to consider the nature of the issue, potential ways forward and text for inclusion in the Consultation Paper.
Other supporting items	None
Prepared by	Paul Mason
Actions for this meeting	<p>Advise on:</p> <ul style="list-style-type: none"> • The description of the issue and its relationship with other topics • Links to other international standard developments, national standards or other guidance • The need for any further input

Presentation of Financial Statements

Part 1 – Advice Sought

1. Consultation Paper Draft

- 1.1 At the TAG meeting on November 4 2019, the TAG agreed that presentation of financial statements should be included in the short list of issues to be included in the Consultation Paper.
- 1.2 Part 2 of this paper has been drafted for discussion, with the aim that the text is capable of being inserted directly into the Consultation Paper, subject to any drafting comments. There are challenges in finalising the drafting of this topic paper, given the interplay with Part 1, which is being revised following TAG input.

#	Question
1	What comments does the TAG have on Sections 1 and 2?
2	Do the summaries of national-level and international guidance in Sections 3 and 4, together with Annex A, accurately reflect the current standards/ guidance? Is the TAG aware of any other guidance on narrative reporting issued by national standard setters or other regulatory bodies that should be included in the Consultation Paper?
3	Does the TAG agree with the presentation of the key issues in section 5, which link to other topics for inclusion in the Consultation Paper?
4	What comments does the TAG have on the proposed SMCs in relation to this topic and are there other specific SMCs that could be raised?

2. Next steps

- 2.1 The text drafted below will be included in the Consultation Paper subject to any further comments from the TAG. The Practitioner Advisory Group will be consulted on any specific issues raised by the TAG further to this discussion.

#	Question
5	Is there specific input to be sought from the PAG?

May 2020

Narrative Reporting

Part 2 - Draft Consultation Paper Text

1. Description of the issue

- 1.1 The nature of NPOs and the way many NPOs are funded raise some unique financial reporting issues that impact the content and the presentation of financial statements. In particular, the fact that NPOs receive funding that has conditions or restrictions 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. It may not be clear which amounts in the financial statements can be used by the NPO for its ongoing activities, and which can only be used in relation to the purposes for which they were given.
- 1.2 Similarly, some donations may be in the form of an endowment, which must be invested. While the NPO can use the interest earned from the investment, the capital itself cannot be used by the NPO. Again, this may not be clear from the financial statements.
- 1.3 The financial statements, which provide information to a wide range of stakeholders 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.
- 1.4 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 are not usually visible in financial statements.
- 1.5 Donors may also 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 expenditure that has been committed but not yet incurred, and which is therefore not yet recognised in the financial statements. Similarly, some donors may permit services in-kind received by the NPO to count against the total cost of a project even if such amounts are not recognised in the financial statements.
- 1.6 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. NPOs may have difficulty in knowing when it is appropriate to create separate reserves and how to manage them. Reporting significant transfers between reserves may obscure the NPO's performance, particularly if funds are transferred to reserves in years when there is a surplus, but withdrawn and used for the NPO's ongoing operations if there is a deficit in the year.

2. Financial reporting challenges

- 2.1 The nature of the different types of funds that make up the NPO's net assets provide a financial reporting challenge. Separating funds that distinguish between the net assets that are restricted for particular purposes and those that can be applied to any purpose at the discretion of the NPO could provide greater transparency.
- 2.2 This could be addressed by maintaining separate financial statements for each type of fund or reserve (fund accounting). Presenting each fund or reserve may be feasible where the 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. Whilst this may increase transparency, it could increase the costs for NPOs.
- 2.3 The income statement generally lends itself to a fund presentation, but more difficulties arise with the other financial statements. 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.
- 2.4 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.
- 2.5 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. Disclosing the accounting treatment in the financial statements could assist users.

- 2.6 Also, where a donation has been received in one financial year but the related expense doesn't happen until a subsequent financial year, users may not understand the timing issues. This could be addressed by explaining in the notes how such amounts are presented in the balance sheet.
- 2.7 Where an NPO decides to set aside other amounts for specific purposes for internal management reasons, reporting these separately from the NPO's other finances can provide greater transparency about the NPO's operations and the amounts available to fund its ongoing operations. Reserve management is primarily a financial management issue; however, disclosure of an NPO's policies on reserves may help stakeholders understand management's decisions. NPOs may find it helpful to have guidance on when reserves should be created and how they should be managed.
- 2.8 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. Balancing the competing needs of different stakeholders must be considered.

3. Current international guidance

- 3.1 Currently international guidance on the presentation of financial statements is included in the following standards¹:
- IAS 1 Presentation of Financial Statements
 - IAS 7 Statement of Cash Flows
 - Sections 3 – 8 IFRS for SMEs²
 - IPSAS 1 Presentation of Financial Statements
 - IPSAS 2 Cash Flow Statements
- 3.2 Under IFRS and IFRS for SMEs, 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

¹ Other standards also include presentation and disclosure requirements. These are not included in the discussion of this topic.

² The International Accounting Standards Board has initiated a programme to review IFRS for SMEs and in particular to consider updates for IFRS standards issued since the last update.

financial statements. The statement of cash flows may be presented using the direct or the indirect method.

- 3.3 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 or IFRS for SMEs are presented in the statement of changes in net assets/equity under IPSAS.
- 3.4 IFRS, IFRS for SMEs 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.
- 3.5 These standards do not include any guidance on the issues raised in section two. 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 would currently need to use their own judgement in determining an appropriate format for each financial statement. This reflects the fact that current international standards are not designed for NPOs.

4. National-level guidance

- 4.1 Where national standard setters follow international standards, the principles established in section three above largely apply in national standards. Three national standard setters have standards based on international standards (one based on IFRS, one based on IFRS for SMEs and one based on IPSAS). While these national standards 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 two. However, the latter two national standard setters provide additional guidance that addresses at least some of these issues.
- 4.2 The national standards based on IFRS for SMEs provide 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 the 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 the NPO using the interest (either for a specific purpose or for its ongoing activities). The guidance notes that, whilst 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.
- 4.4 The national standard setter 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 national standard setters 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 the 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 all 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. This standard setter 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 The stakeholders who may be interested in the financial statements include past, current and potential funders, donors and financial supporters of the NPO, beneficiaries of the NPO's activities as well as wider civil society. The information provided in the financial statements should meet the general information needs of these stakeholders.
- 5.2 The general needs of stakeholders underpin the work of international standard setters in the private and public sectors. In these international accounting standards, financial statements include a statement of financial position (a balance sheet), an income statement (activity statement or performance statement), a cash flow statement and a statement of changes in net assets or equity. These standards provide that, in these statements, assets, liabilities, income and expenditure should be broken down into material categories, with such information needed to give stakeholders a full picture of an organisation's financial position and performance.
- 5.3 The international standards set minimum requirements for the presentation of financial statements. All of the alternatives take these minimum requirements as the starting point. More guidance is proposed in all of the alternatives for NPOs regarding the presentation of net assets (or equity).
- 5.4 The approaches taken in national accounting standards have also informed the development of the alternative approaches. Some national standards permit the use of either the deferral method or the fund accounting method for presenting restricted contributions. Under the deferral method, a liability is recognised for the restricted contributions. Contributions are recognised as revenue as stipulations are met. This approach does not require separate fund accounting, and is the approach taken in the international standards.
- 5.5 Under the fund accounting method, restricted contributions are recognised as revenue immediately and presented in a separate fund. The related expenditure is presented in the same fund. It is possible that a liability recognised under the deferral approach is presented in a separate fund.
- 5.6 The presentation approach chosen will depend, at least in part, on how restricted contributions are recognised. The recognition alternatives are discussed in the chapters on incoming cash transfers and gifts in-kind.
- 5.7 As a result, the first alternative is to retain the requirements in the international standards unchanged but provide supplementary guidance for NPOs on how

additional information could be included in the statements where this is relevant for their stakeholders. This could involve disclosures on restricted funds.

- 5.8 National accounting standards have additional requirements to the minimum requirements in the international standards. For example, some national standards 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, as well as the total required by the international standards. This approach of extending the requirements in the international standards has been used in developing the remaining alternative approaches.
- 5.9 The second alternative requires the use of fund accounting, which is required or permitted by a number of national accounting standards. The use of fund accounting would require that records are kept for each fund and 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 disclosures on the face of the statement of financial position.
- 5.10 The third alternative adds a 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 the requirements of most financial statements and has the potential to meet the reporting needs of major donors.
- 5.11 All of the alternatives include disclosure of the accounting policy for the management of reserves on the basis that this could include transparency.



	Description	Advantages	Disadvantages
<p>Alternative 1 ‘Do nothing’ Use existing international standards 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 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. 	<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>Stakeholder</p> <ul style="list-style-type: none"> May be less faith placed in such information, given the lower level of assurance by auditors. <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>Require NPOs to use fund accounting in the preparation of the financial statements, disclosure of reserves policy and to prepare supplementary fund/project statements for material funds/projects</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"> • Retains existing presentation of financial statements as the start point. • 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.

Specific Matters for Comment

1. Do you agree that the list of alternative treatments that should be considered is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.
2. Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment? If you do not agree, please set out the changes you propose, and why these should be made.
3. Please identify the alternative treatment that you favour, and the reasons for your view.

[Draft generic questions for further discussion]

Annex A – Presentation of financial statements

	IFRS and IPSAS	UK	Australia	New Zealand	Canada	USA
<p>Alternative 1</p> <p>Use existing international standards with additional NPO specific guidance on the provision of additional information to meet stakeholder needs.</p>	<p>IFRS, IFRS for SMEs 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>Although the Canadian standards are not based on international standards, the requirements are similar, and the Canadian standards permit but do not require the presentation of additional information.</i></p> <p>CPA Canada Handbook – Accounting, Section 4400 and CPA Canada Public Sector Accounting Handbook, PS 4200 permit, but do not require, the use of fund accounting in all financial statements.</p> <p>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</p>	

	IFRS and IPSAS	UK	Australia	New Zealand	Canada	USA
					(other than endowments); and unrestricted net assets.	
<p>Alternative 2</p> <p>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 funds and unrestricted funds to be presented separately. Income is reported as either restricted or unrestricted. Expenditure is shown as unrestricted. As conditions imposed by the donor are satisfied, net assets are reclassified from restricted to unrestricted to match the expenditure.</p>
<p>Alternative 3</p> <p>Require NPOs to use fund accounting in the preparation of the financial statements, disclosure of reserves</p>						



**INTERNATIONAL FINANCIAL REPORTING
FOR NON PROFIT ORGANISATIONS**

	IFRS and IPSAS	UK	Australia	New Zealand	Canada	USA
policy and to prepare supplementary fund/project statements for material funds/projects.						
Standards/ Guidance References	IAS 1 <i>Presentation of Financial Statements</i> IAS 7 <i>Statement of Cash Flows</i> Sections 3 – 8 <i>IFRS for SMEs</i> 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 Canada Handbook – Accounting, Section 4400 <i>Financial statement presentation by not-for-profit organizations</i> and CPA Canada Public Sector Accounting Handbook, PS 4200 <i>Financial statement presentation by not-for-profit organizations</i>	Accounting Standards Codification (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>