Practitioner Advisory Group

AGENDA ITEM: PAGCP04-01
4 August 2020 – Online

Cash-based and modified-cash accounting practices

Summary	The paper outlines our approach to handing the potential disconnect between accrual-based general purpose financial statements and the requirement from some donors that NPOs submit project based reports on a cash or modified cash basis.
Purpose/Objective of the paper	This paper sets out proposals on: • How to acknowledge this issue in the Consultation Paper (CP) • A Supplementary Resource, distinct from the CP, including: ➢ a 'Map of NPO Accounting Practice Complexity'. ➢ possible practical accounting solutions • The placement of the above Resource.
Other supporting items	None
Prepared by	Sam Musoke
Actions for this meeting	Advise on proposals: • For the references to the issue in the Consultation Paper • For the description, placement and timing of the Supplementary Resource • For the content of the Supplementary Resource

Practitioners Advisory Group

Cash-based and modified-cash accounting practices

1. Background

1.1 The IFR4NPO project is developing Guidance to address the needs of readers of general purpose financial reports of non-profit organisations, who include a wide range of stakeholders. As outlined in the Consultation Paper Preface 3.2 and Part 1 Section 3, it is our premise that accruals-based Guidance is most appropriate to meet the project objectives.

1.2 In the PAG meeting in December 2019, it was noted that reporting to donors with respect to the grants or projects they fund is often done on a cash or modified cash basis. Since the same accounting ledger and transactions should form the source for both general and special purpose reports, this presents a pragmatic challenge for grant funded NPOs required to prepare financial reports on different bases.

1.3 In subsequent PAG meetings, the concern was raised that readers of the Consultation Paper may exclude themselves inappropriately from the consultation process if they perceive that fully accrual-basis general purpose financial reports are not an option they could consider because of potential conflicts with current and future reporting requirements of donors.

1.4 A further concern was noted, that smaller NPOs, or those using simple cash-basis accounting, might struggle to see a pathway to move from their current accounting practice to the more sophisticated or complex requirements associated with meeting the accrual-based IFR4NPO Guidance.

1.5 In light of the above, previous PAG meetings have included advice to:

- Engage with donors early to understand and influence the practice of requiring cash and modified cash basis reports.

- Acknowledge the practical challenges associated with cash and modified cash basis project reporting requirements within the Consultation Paper
- Highlight some common accounting practices in NPOs that are relevant to particular issues in Part 2.
- Consider outlining the difference between cost accounting and financial accounting in the discussion on donor reporting requirements.
- Consider cash and modified cash basis standards to inform the IFR4NPO Guidance.

1.6 In response to these interrelated issues, this paper sets out:

- References made in the draft Consultation Paper to acknowledge these issues;
- Distinct from the CP, a Supplementary Resource (Annex A) setting out a map of NPO accounting practice complexity, and some possible pragmatic accounting solutions to addressing the challenges; and

2. Relevant references in the Consultation Paper (CP)

2.1 The preface Para 3.2 states that providing accrual based Guidance will be critical to international applicability, and acknowledges that the challenges involved are not underestimated given the prevalence of cash-based or modified accrual reporting. Reference is made to Part 1 Section 3 where this is explored in more detail.

2.2 CP 2.4 recognises funders as an example of external stakeholders that NPOs are accountable to, and acknowledges that they will make decisions based on the information provided to them

2.3 CP 2.8 recognises resource providers as one of three broad groups of external stakeholders that NPOs are accountable to.

2.4 CP 2.18 cites diversity in donor reporting requirements as a driver in diversity in current financial reporting practice.

2.5 CP 2.21 – 2.25, under the heading 'Donor reporting arrangements', explores the causes and impacts of donor reporting requirements, but without referring to accounting basis.

2.6 CP 3.2 introduces 'accrual basis accounting' as a core proposition, and that the chapter will explain the rationale for it.

2.7 CP 3.4 - 3.13 sets out the core rationale for the proposition that the Guidance be developed on an accrual basis, including Table 3.1 with a comparison of the three accounting basis in relation to the project objectives.

2.8 General Matters for Comment 3.1a) invites respondents to comment on the proposition that the Guidance should be accrual based.

Question 1: Do PAG members feel that the above references and explanations are adequate to acknowledge these issues, and avoid potential disengagement by CP readers due to perceived irrelevance? If not, what changes would members suggest?

3. Placement of Supplementary Resource

3.1 The Supplementary Resource presented in Annex A to this paper addresses pragmatic issues associated with the implications of accrual based general purpose financial statements. However, it is not part of the Guidance, and is different from the supplementary material provide as part of the consultation paper.

3.2 While we hope it will be helpful to some NPOs, there is a risk that readers may confuse it with the Guidance and CP material, or that the content constitutes formal recommendations of the project, which it does not. It will be very important to ensure it is described and positioned in a way to avoid those risks.

3.3 It is therefore proposed to make it clear that the Supplementary Resource is distinct from the Financial Reporting Guidance itself.

3.4 The map would be presented in such a way that users have the ability to suggest additions, changes and improvements until a final version is settled on at the same time as the launch of the Final Guidance.

Question 2: Which types of stakeholders do PAG members think this material might be most useful for?

Question 3: Which modalities might be most helpful for relevant users to access the resources while minimising confusion with the Guidance itself?

Question 4: Do PAG members have suggestions for the timing of the release of these resources, ie before of after the CP or Exposure Draft?

4. Content of Supplementary Resource

4.1 The Supplementary Resource in Annex A was developed at the same time as the draft consultation paper was being finalised. Please note that there is some overlap and a few inconsistencies which are yet to be ironed out, but are presented none the less, in the interest of receiving timely feedback.

4.2 The Supplementary Resource, which is separate from the Consultation Paper, first establishes the goals of bookkeeping and accounting for NPOs, which include but extend beyond the production of financial reports.

4.3 The terms cash, modified cash, accrual and hybrid accounting are clarified. The practical challenges presented by having accounting records, special purpose financial reports and general purpose financial reports on different bases.

4.4 A map is presented, that sets out some of the accounting practices that might characterise a journey from the simplest cashbook-only based cash accounting to more complex full accrual accounting.

4.5 For each accounting practice, a table sets out a more detailed description, together with examples and comments. Many issues do not have an interplay with the Guidance, but those that do are marked with an asterisk (*).

4.6 Finally, the material sets out some potential accounting options that individual NPOs may choose to adopt depending on their circumstances, each with their respective advantages and disadvantages.

4.7 Finally, the Supplementary Resource includes some scenarios, possible accounting treatments and reporting impact for some of the accounting practices described in the complexity landscape. This is conceived as a resource to describe possible treatments rather than holding the status of formal guidance.

4.8 Issues with an asterisk (*), that are planned to be addressed in the Guidance, will not have associated scenarios or worked examples, as these will be provided as part of the Exposure Draft.

4.9 Only one scenario, relating to Accounting Practice 6.3, is presented in this paper, to demonstrate one pragmatic approach that NPOs might employ if they report a prepayment on a grant funded direct expense on a cash basis, but also wish to produce accrual basis accounts each month.

Question 5: What comments do PAG members have with respect to the proposed content and structure of the Supplementary Resource in Annex A?

August 2020

INTERNATIONAL FINANCIAL REPORTING
FOR NON PROFIT ORGANISATIONS

Annex A

IFR4NPO RESOURCE – *Practical implications for NPO accounting and production of financial information*

1. Goals of accounting in NPOs

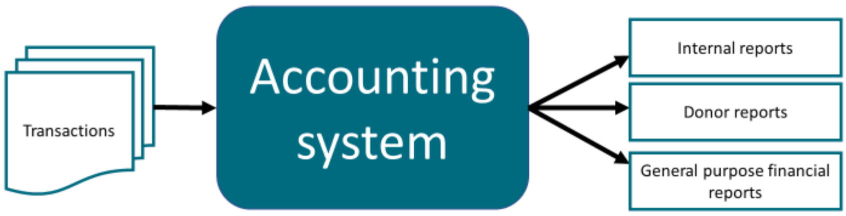
1.1 The goals of bookkeeping, accounting and financial reporting in NPOs are threefold:

- Provision of useful information for internal and external users;
- Leveraging accounting practice to apply effective internal controls; and
- Maximisation of cost recovery to ensure financial sustainability.

1.2 Accounting and financial reporting systems and processes should be appropriate to the context of the organisation; there may be cost / benefit trade-offs to increasing complexity or sophistication.

1.3 The IFR4NPO Guidance will describe how to present general purpose financial reports that give a true and fair view on an accrual basis. An organisation that is required to, or chooses to apply the Guidance will need to establish accounting systems to produce those reports.

1.4 An NPO accounting system needs to be set up in such a way that it can provide information for both internal users (such as project managers, budget holders, management and board) and external users, including funders and the General Purpose Financial Reports.



CIPFA The Chartered Institute of Public Finance & Accountancy

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2. Accounting basis

2.1 **'Cash accounting'** records transactions at the point when money is received and paid. Maintaining cashbooks for different bank or mobile money accounts, cashboxes and staff working advances is an essential bedrock of all accounting. In pure cash accounting, payments for assets are recorded as expenses; depreciation or asset disposal are not captured. Pure cash accounting does not keep track of debtors or creditors, prepayments, accruals or commitments.

2.2 The financial reporting output from a pure cash accounting system is effectively a cashbook summary, called a receipts and payments report, showing the opening cash/bank balance, receipts by category, payments by category and closing cash/bank balance.

2.3 **'Accrual accounting'** recognises income and expenditure at the point when it is earned or accrued, as distinct from when it is received or paid. Accrual accounting also requires the capitalisation of fixed assets, and recognition of stocks, debtors and creditors. Money spent on a vehicle or building, does not then appear in expenses. Income may be recognised on the basis of entitlement, whether or not it is actually in the bank.

2.4 The financial reporting outputs from a pure accrual accounting process are an income statement (also known as income and expenditure, profit and loss, statement of financial activities) and a balance sheet (also known as statement of financial position).

2.5 '**Modified cash**'. If an NPO uses a mixture of cash and accrual accounting, recording some types of transactions on a cash basis and others on an accrual basis, that is described as keeping books on a '**modified cash**' basis.

2.6 There is a distinction between the way an NPO maintains its accounting records during the year, and the basis on which the financial reports are produced. An NPO may maintain its books on a cash or modified cash basis during the year, then make adjustments only at the end of the year, sometimes with the technical assistance of professional accountants / auditors, to produce year end financial statements on an accrual basis. This is called the **'hybrid method'**.

2.7 In some instances, it may be useful to a funder and/or the NPO to have reports prepared on a cash or modified cash basis. For this reason, some NPOs adopt the hybrid approach, maintaining books on a cash or modified basis during the year, even if they have the capacity and resources to produce accrual-based information that could be valuable throughout the year.

2.8 Fig 1 sets out the potential advantages and disadvantages from the viewpoint of a generalised grant funded NPO, of having accounting records, donor/project reports and year-end general purpose financial statements on different accounting bases. This table assumes the NPO has the resources and capacity to produce and use accrual-based information.

Figure 1

State	1	2	3	4	5
Accounting records basis	Cash	Cash	Modified	Accrual	Accrual
General purpose reports basis	Cash	Accrual	Accrual	Accrual	Accrual
Donor reports basis	Cash	Cash	Modified	Modified	Accrual
Similar reports used by project managers, donors, management and board	Yes	No	Yes	Yes	Yes
Donor reports reconcilable to year end accounts (subject to period and currency adjustments)	Yes	No	Yes	Yes	Yes
One system generates all reports.	Yes	Yes, with year-end effort	Yes, with year-end effort	Yes, with effort at each reporting cycle	Yes
Entity wide, decision useful information for all users	No	Yes	Yes	Yes	Yes

State 1: With all information on a cash basis there is internal consistency, but the problem of a lack of useful financial information that could support decision making, accountability and credibility is the central reason for the IFR4NPO Project.

State 2: If accrual-based general reports are produced but accounting records and donor project reports are prepared on a cash basis through the year, this is arguably an even worse situation than state 1. Internal users may not understand or value the year end accounts which bear little resemblance to the reports they see through the year. Current funders may find minimal value if the reports they receive (and often audit separately) cannot be reconciled to the organisation wide accounts. Auditors are at greater risk of failing to identify double funding fraud.

State 3: If accounts are maintained on a modified cash basis (At level 4, 5 or 6 as per Figure 2 below) to match donor reporting requirements during the year, and the number of year-end adjustments needed to produce full general purpose accounts at the year-end is minimised, then this is potentially workable, depending on the NPOs circumstances.

State 4: If accounts are maintained on an accrual basis throughout the year, even internal users have access to decision-useful information. If the amount of work required to produce donor reports each reporting cycle is not too onerous, then this is also potentially workable.

State 5: The internal consistency and decision usefulness of having all reports on an accrual basis would seem an ideal state. However, in some cases, there may be a cashflow advantage to the NPO of reporting prepayments (such as medical insurance) or asset purchases on a cash basis. Furthermore, given the current prevalence of donors to require cash or modified cash basis reports, this state might be unrealistic in many contexts.

3. NPO accounting practice complexity map

3.1 Figure 2 below sets out a range of NPO accounting practices on the spectrum from simple to complex. The aspects of complexity include the following factors that are relevant to the goals of NPO accounting as set out in Para 1.1:

- The accounting basis used for common types of transactions;
- The maintenance of memorandum ledgers outside the accounting system for information purposes;
- Fund accounting and cost accounting, relevant to the provision of project-based information and cost recovery; and
- Whether the accounting practice is done in real time, monthly or only at year end.

3.2 The accounting practices are organised in levels 1 to 7, with 1-3 being cash basis, 4-6 modified cash basis and 7 full accrual basis.

3.3 The complexity map may be used to understand the level of an NPO's current accounting, or to consider the next appropriate steps to increase accounting sophistication according to the organisation's needs.

3.4 The map does not include every type of transaction or accounting practice applicable to every NPO, rather sets out the common and significant steps from the simplest to most complex.

3.5 Certain accounting practices may not be applicable in certain contexts (for example 2.1 maintaining cashbooks in multiple currencies for a domestically funded domestic NPO).

3.6 An NPO may use a more advanced accounting practice instead of a simpler version, rather than both (for example 4.3 recognising supplier invoices using an accounts payable sub-ledger instead of 2.1 maintaining an unpaid bills register.)

3.7 The complexity map includes the following accounting practice that is commonly found, born from a desire to meet funder reporting requirements, but not necessarily recommended practice:

- 5.1 Capitalisation of only those fixed assets not purchased with grant funds

3.8 For an NPO's accounting to be at a certain level (1-7) they should be able to tick (or N/A) each accounting practice in that level and the levels below it.

3.9 The accounting practices in level 3 relate to fund accounting, which may be done irrespective of the accounting basis.

3.10 The map may be used in conversations between NPOs and funders to maximise the alignment between the NPO's accounting practice and what the funder will accept in their reports.

Figure 2: Map of NPO Accounting Practice Complexity

Basis	Cash basis			Modified basis			Accrual basis	
Level	**1**	**2**	**3**	**4**	**5**	**6**	**7**	✓
1.1	One analysis cashbook							
1.2	Multiple analysis cashbooks							
1.3	Tracking internal cash working advances							
2.1		Multi currency cashbooks						
2.2		Maintaining unpaid bills register						
2.3		Maintaining fixed assets register						
3.1			Allocating costs to funds on payment					
3.2			Apportionment of indirect costs					
3.3			Inter-fund adjustments					
4.1				Payroll journal to recognise liabilities				
4.2				Tracking salary advances and loans				
4.3				Accounts Payable - supplier invoices / payments				
4.4				Accounts Receivable - client invoices / receipts				
5.1					General purpose fixed assets capitalised			
5.2					Recognise inventory unused or unsold at year end			
5.3					Adjustments for accrued / prepaid costs at year end			
5.4					Adjustments for accrued / deferred income at year end			
6.1						Adjustments for accrued / prepaid indirect costs at month end		
6.2						Adjustments for accrued / prepaid direct costs at month end		
6.3						Adjustments for accrued / deferred income at month end		
6.4						All fixed assets capitalised		
6.5						Allocating costs to funds on use		
6.6						Real time inventory tracking		
6.7						Recognition of donations-in-kind		
7							Recognition of all applicable assets and liabilities in real time	

4. Accounting practice description, examples and comments

	Description	Examples and comments	*
1.1	The NPO maintains one cashbook that itemises receipt and payment transactions and assigns each to categories for summary purposes.	May be hand-written (eg manual cashbooks), electronic worksheets (eg Excel), or in an accounting software.	
1.2	The NPO maintains cashbooks for each cash, bank and mobile money account, and adds the cashbook summaries together to produce financial reports	Bank accounts, cash held in different locations or by different people, petty cash imprest, unbanked cash receipts control, mobile money	
1.3	The NPO gives cash 'working advances' to staff and records the expense only when and to the extent that they have provided receipts as accountability.	Staff advances may be tracked using debtors accounts within an accounting system, but could also be considered as organisational cash held internally in the custody of someone other than the cashier. This is therefore still 'cash basis' accounting, even though it requires use of a 'non-cash' journal entry to liquidate the advance and recognise the cost to the NPO.	
2.1	The NPO maintains cashbooks in more than one currency	The NPO holds donor funds in a dedicated donor currency bank account to limit exchange rate risk, and/or as required by the donor, and also maintains home currency bank and cash accounts.	
2.2	Outside of the accounting system, the NPO maintains a file or list of unpaid bills or invoices so that it can easily identify amounts due not paid.	This provides 'accrual-based' information but without making accounting adjustments. The information is not subject to double-entry controls.	
2.3	Outside of the accounting system, the NPO maintains a register of fixed assets for the primary purpose of control and compliance rather than accounting.	This register could contain information including date of purchase, acquisition or disposal, references to supporting documents, cost or value, donor or project, identifier, location or custodian. It may or may not include information about useful life and depreciation charges. Even if the register provides 'accrual-based' information, and supports asset management, it is not used to	

	Description	Examples and comments	*
		make entries in the accounting system or subject to double-entry controls.	
3.1	The NPO is able to categorise each transaction not only by account, but also by fund, eg donor or project.	Funds are a type of cost centre that record transactions for a specific project, donor or purpose. Funds may be also be used to track and apportion indirect costs. For example, medical insurance costs are charged according to the projects or departments where the respective staff work. Depending on the level of legal or fiduciary restriction on the use of funds, such allocations may be considered to be part of 'cost accounting' rather than 'financial accounting'.	*
3.2	Indirect costs which support the running of the organisation as a whole rather than being attributable projects, are tracked and allocated to projects or funds.	This may be done within or outside the main accounting system. The amount charged to projects could be calculated based on the amount apportionable according to some fair and justifiable basis, and/or the amounts or percentages allowed by the donor or grant agreement. More sophisticated systems will enable the calculation of the true cost of a project including applicable overheads, compared to the amount recovered from donors, to ascertain the extent to which each project is contributing to or drawing on organisation funds. This forms part of cost accounting rather than financial accounting and might not feature in general purpose financial reports.	*
3.3	Amounts are transferred from one fund to another with or without equivalent movement of physical cash.	This is a 'non-cash' transaction, but may still form part of 'cash-basis' accounts. For example, an expense charged to a project in a previous year is subsequently found to be disallowed according to donor rules and must be funded instead from general funds. Or a completed donor funded project has incurred costs in excess of the funding available, so costs are transferred to the general fund to avoid presenting a fund with a permanently negative balance. Depending on the	

	Description	Examples and comments	*
		level of legal or fiduciary restriction on the use of funds, such inter fund transfers may be considered to be part of 'cost accounting' rather than 'financial accounting'.	
4.1	A payroll journal is entered to recognise payroll taxes, social security contributions and net pay due.	This is one of the most common forms of NPO transaction that generates a liability. Use of a payroll journal confers advantages in terms of internal controls and cost allocation, as well as providing information about liabilities. Some organisations settle the taxes before the same month end to ensure that such costs may be charged to donors requiring cash-/based accounts. Some donors accept gross salary allocations knowing payroll liabilities will be settled the following month.	
4.2	A salary advance or staff loan is recorded as a debtor or prepayment and recovered through the payroll rather than expensed to salary costs at the time of payment.	Monitoring salary advances and loans and their recovery (via the payroll) in the accounting system is important for internal control and tax compliance purposes, as well as providing information about assets and liabilities. Some NPOs are keen to provide advances or loans to staff as part of their HR policy, and tracking them via the balance sheet enables the correct amount to be charged to projects each month, while having visibility of unrecovered loans or advances.	
4.3	An 'Accounts Payable' or suppliers / vendors ledger is used to record invoices (expense and liability) in the accounting system separate from the payment.	In addition to providing information about liabilities, which is helpful for cashflow planning and management, this provides information about purchases by supplier which may be useful in fraud prevention and detection, as well as price negotiation.	

	Description	Examples and comments	*
4.4	An ‘Accounts Receivable’ or ‘customer' ledger is used to record invoices (income and debtor) in the accounting system, separate from the receipt of cash.	This may be useful to NPOs providing goods or services for a fee or contribution. Invoices may also be used as a mechanism to request funds from donors, or to record the use of education bursary funds. This provides information about amounts receivable (current assets) which is useful for managing cashflow and the operational or working capital that the NPO needs to maintain its business.	
5.1	Assets purchased with organisation funds (as opposed to donor funds) are capitalised to the balance sheet and depreciated in accordance with their useful life.	Information about the assets available to the NPO is useful in assessing efficiency, identifying income generation opportunities, and understanding the age and possible assets replacement needs. Depreciation costs associated with 'indirect' assets (those used in support activities) may be included in indirect cost allocations to projects whereas the asset purchase cost may not be allowable. Reconciliation of the figures in the double entry ledger to the fixed asset register provide a powerful internal control. Some organisations exclude donor funded assets from capitalisation because of the need to show purchase cost rather than depreciation in donor reports and/or questions around asset ownership (see 6.4).	*
5.2	If an expense account is charged on the purchase or acquisition of inventory items, an adjusting entry is made to recognise unused amounts still held at the year end.	Inventory might include medical or laboratory supplies used to deliver services, food or shelter related items for distribution in an emergency context, unused office or cleaning supplies, or donated items for sale.	*
5.3	Recognising accruals and prepayments for costs at the year- end provides more reliable picture of assets and liabilities, particularly where these are material. This is commonly done for organisations that maintain	Common accruals adjustments include audit fees, telephone bills and other expenses paid at the start of the following year that related to the previous year. Common prepayment adjustments include rent and insurance. If the NPO itself does not have a good understanding of these adjustments (made by auditors) there is a risk of	

	Description	Examples and comments	*
	their books on a cash or modified cash basis during the year and make adjustments (perhaps with the support of auditors) for their year-end audited accounts.	inconsistency between the audited accounts and the ledger, or confusion about how to reverse such adjustments.	
5.4	Recognising accrued or deferred income at the year-end provides a more reliable picture of assets and liabilities, particularly where these are material. Income, even non-exchange income, may be receivable on account of contractual obligations, or may require deferral on account of time or use restrictions, or unmet conditions.	If the NPO does not have a good understanding of these adjustments there is a risk of inconsistency between the audited accounts and the ledger, or confusion about how to reverse such adjustments. The basis of income recognition will depend on the organisation's accounting policy and is a matter of great significance for general purpose financial reporting, since income is often an indication of size.	*
6.1	All assets, whether funded by donors or otherwise, are capitalised and depreciated, provided they are owned by the organisation.	There are various questions about the depreciation that should be charged, for example if the asset is required to be returned at the end of the project, has use restrictions, or if the asset is in seasonal or sporadic rather than continual use, perhaps in storage for a year or more in between periods of use on different projects.	*
6.2	Recognising accruals and prepayments for indirect costs smooths the monthly charges and results in fairer apportionments to donors or projects that may start or stop through the course of the year.	For example, medical insurance for indirect staff, or office rent paid in advance, or organisational audit fee that might otherwise only be accrued during the audit process, too late to charge to funders.	
6.3	Recognising accruals and prepayments for direct costs may give a stronger link between the costs shown and the activities carried out. It also provides	For example, a workshop event carried out in April, but venue costs not invoiced or paid until May. Or field office rent paid 2 years in advance.	

	Description	Examples and comments	*
	important information about assets and liabilities		
6.4	Adjustments to defer or accrue income at each month end are particularly helpful for exchange income.	For example, where a financial year end comes in the middle of an academic term, or where income for services has been earned but not billed (possibly requiring recognition of work in progress)	*
6.5	One particular supply item may be used on a number of projects. The NPO holds the items on the balance sheet on purchase (as inventory, or in a control account), and expenses to different projects or funds only at the time of use.	Eg Fuel usage against a prepaid card, internet data, or office supplies	*
6.6	Inventory items are recorded to the balance sheet at time of acquisition, and expensed (to one or more funds) on issue. The balance on the inventory account at any one time is represented by a verifiable list of items, with unit quantities and values.	Eg medical supplies. This may be become more complex if additional spend on items (eg packaging or transport to place of use) is attributed to item value. Or donated items for sale. There may be cost / benefit trade-offs.	*
6.7	Donations in kind are recognised as income, along with the corresponding expense or asset	Eg fixed assets, access to assets, inventory, supplies, or services, potentially volunteers.	*

* The IFR4NPO Financial Reporting Guidance plans to address sector-specific issues relating to income recognition, fund accounting, fixed assets, inventory and donations in kind.

5. Scenario, accounting treatment and reporting impact for Accounting Practice 6.3

5.1 Scenario: The rental cost of a building, a grant funded direct project cost, is chargeable in full to Donor 1. The NPO secures a good rate on an ideal property and pays $24,000 for two years' rent ($1,000 per month) on 1 Jan 2021. The NPO would like to include the full amount in its donor report in order to liquidate the advance (or receive reimbursement), which is allowable according to the donor's rules. The NPO prepares monthly management accounts recognising adjustments for prepayments and accruals. The NPO is not required to apply IFRS16 on leases.

5.2 The pragmatic accounting solution suggested below is not to be considered a formal recommendation of the IFR4NPO Project or requirement of the IFR4NPO guidance.

5.3 Double entry:

Make use of a cost centre (project / fund) code specifically to track accrual basis timing differences on donor funds that need to be reported on a cash basis.

1. On payment of the rent

	Account	Cost centre	Dr	Cr
Dr	Rent expense	Donor 1	24,000	
Cr	Bank			24,000

2. Adjustment to recognise prepayment 31 Jan 2021

	Account	Cost centre	Dr	Cr
Dr	Prepayments		23,000	
Cr	Rent expense	Timing diff		23,000

3. Adjustment to release prepayment each month until Dec 2022

	Account	Cost centre	Dr	Cr
Dr	Rent expense	Timing diff	1,000	
Cr	Prepayments			1,000

5.4 Reporting impact

At 31 Jan 2021

Income statement extract for the month

	Donor 1	Timing diff	Total
Rent	24,000	(23,000)	1,000

Income statement extract year to date

	Donor 1	Timing diff	Total
Rent	24,000	(23,000)	1,000

Balance sheet extract

	$
Prepayments	23,000

At 31 Dec 2021

Income statement for the month

	Donor 1	Timing diff	Total
Rent		1,000	1,000

Income statement year to date

	Donor 1	Timing diff	Total
Rent	24,000	(12,000)	12,000

Balance sheet extract

	$
Prepayments	12,000

At 31 Dec 2022

Income statement for the month

	Donor 1	Timing diff	Total
Rent		1,000	1,000

Income statement year to date

	Donor 1	Timing diff	Total
Rent		12,000	12,000

Balance sheet extract

	$
Prepayments	-

5.5 Advantages and Disadvantages

Advantages:

- Cash flow / working capital – cash cost recovered from donor
- Donor reporting requirements met
- Balance sheet is accurate
- Monthly and annual rent expense overall is correct

Disadvantages:

- Cost centre or column to track 'timing differences' can show confusing negative expenses
- Monthly prepayment reversal to 'timing differences' fund poses risk of posting error