



## Practitioner Advisory Group

AGENDA ITEM: PAGED10-02

07 June 2023 – Online

### Classification of Expenses

Summary	The paper provides an overview of the proposed approach to developing the Exposure Draft for the Classification of Expenses and seeks PAG views on the expense information that users might find important.
Purpose/Objective of the paper	<p>The paper identifies the approaches to financial reporting guidance for the classification of expenses included in the Consultation Paper, preferences received, and further developments that have occurred with both international standards and the development of the Supplementary Statement.</p> <p>It seeks PAG views on the expense information that they consider users would find important to be presented in NPO general purpose financial reports and that should be examined as proposals are developed. It also seeks PAG views on the practical implications for NPOs of producing this expense information.</p>
Other supporting items	N/A
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Actions for this meeting	<p><b>Advise on</b> the</p> <ul style="list-style-type: none"><li>(i) expense information that users consider important that should be presented in NPO general purpose financial reports and</li><li>(ii) practical implications of producing this expense information.</li></ul>

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## Classification of expenses

### 1. Introduction

- 1.1 Expense information is important to understanding how an NPO uses the resources that have been entrusted to it. Expense information can be presented in different ways. Historically, information has typically been presented using a natural classification or a functional classification, noting that some classification terms could fit in either.
- 1.2 A natural classification of expenses describes the nature of the expense, e.g. salaries, rent, electricity, in other words, the source of the expense item.
- 1.3 A functional classification describes the purpose of the expense in terms of the activities of an organisation, e.g. service delivery, client support, aid distribution.
- 1.4 This paper provides:
  - an overview of the proposed approach to developing the Exposure Draft for Classification of Expenses; and
  - seeks PAG views on the expense information that they consider users find important.

### 2. Approach to Drafting the Exposure Draft for Classification of Expenses

- 2.1 The IFR4NPO Consultation Paper put forward four alternatives for the classification of expenses. These were:
  - **Alternative 1 (international frameworks)** - allow each entity to decide how best to present its expenses based on either their nature or their function.
  - **Alternative 2 (remove choice)** - require either a by nature or functional analysis of expenses.
  - **Alternative 3 (both methods)** - require both to be produced, but a choice as to which classification approach is used for the primary statement.

- **Alternative 4 (hybrid approach)** - combine elements of the nature and function analyses to produce a single analysis.
- 2.2 The alternatives assumed that whichever classification of expenses is used, each class would be disaggregated to provide information that is useful to the users of the financial statements. The Consultation Paper provided for the potential to include a prescribed minimum classification level, information on the allocation of support services, and information needed about how programme/activity information has been aggregated.
  - 2.3 There was no clear view on the most appropriate way ahead from consultation respondents, with advantages and disadvantages outlined and concerns raised about cost/benefit for all of the alternatives proposed.
  - 2.4 Since the publication of the Consultation Paper, proposals for a potential Supplementary Statement have been developed. While primarily based on classification by nature, these proposals would provide some functional information, particularly around support costs. If a whole of entity Supplementary Statement were to be produced it would likely cover both natural and functional spend.
  - 2.5 There has also been some recent developments by the International Accounting Standards Board (IASB). It is considering whether to allow natural analysis, functional analysis or a mix of the two as long as the classification meets the needs of the users of the financial statements. In these deliberations information on certain natural expenses would be required to be presented when a functional analysis is chosen.
  - 2.6 Taking respondents views, and the potential for a Supplementary Statement into account, we propose to consider the implications of the most recent IASB thinking for NPO financial reporting. In taking forward this work, we will consider whether there is a minimum set of natural cost information that would be required for all NPOs and if so, which natural costs and how should they be presented. Similarly, we will consider if there is a minimum set of function information e.g. support costs that would be required for all NPOs.
  - 2.7 If functional analysis is permitted or required as part of INPAG, it is proposed that the guidance would be developed on how functions should be identified and the principles for allocating support costs. This would also take into consideration the presentation of fundraising costs.



**3. What expense information do PAG members consider users find important, and what are the practical implications of producing this?**

- 3.1 Expense information needs to meet the needs of users. We are therefore seeking views from PAG members on the expense information they consider important for NPOs to present in their general purpose financial reports to meet the needs of users.

**Question 1: What expense information do PAG members consider NPOs should be required to present in the general purpose financial reports?**

- 3.2 We are also seeking PAG member views on what the practical implications of producing expense information would be. This will support us in examining the appropriateness of a mixed approach for NPOs, and the minimum natural and or functional information that should be required. This will assist in balancing the needs of users and the potential burden that this might place on preparers.

**Question 2: What are the practical implications of producing expense information for preparers of general purpose financial reports?**

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