



# Technical Advisory Group Issue Paper

AGENDA ITEM: TAGED14-03  
28-29 Sept 2023 – Hybrid

## Section 24 Part II *Classification of Expenses* – Draft authoritative guidance

Summary	The paper provides TAG members with an initial draft of the authoritative guidance for Section 24 Part II <i>Classification of expenses</i> .
Purpose/Objective of the paper	The paper provides TAG members with an overview of developments since this issue was last brought to the TAG. A summary of the methods that it are proposed to be permitted for the analysis of expenses is provided along with proposed mandatory disclosures required regardless of the method of analysis chosen. An initial draft of the proposed authoritative guidance is included in Annex A.
Other supporting items	TAGED 14-02 Fundraising Costs
Prepared by	Philip Trotter
Actions for this meeting	<b><u>Comment on</u></b> the: <ul style="list-style-type: none"><li>• analysis of expense methods permitted and requirements to provide narrative description of natural costs if a functional or mixed presentation is used;</li><li>• the guidance included for the allocation and aggregation of expenses;</li><li>• the factors to be considered when selecting the method of expense analysis; and</li><li>• the mandatory disclosures required to ensure a level of consistency.</li></ul>

# Technical Advisory Group

## Section 24 Part II *Classification of expenses* – Draft authoritative guidance

### 1. Introduction

- 1.1 This paper provides:
- an overview of developments since this issue was last brought to the TAG;
  - a summary of the methods that it is proposed are permitted for the analysis of expenses; and
  - proposed mandatory disclosures required regardless of the method of analysis chosen.

### 2. Developments since this issue was last brought to the TAG

- 2.1 Classification of Expenses was last brought to the TAG at its May 2023 meeting. At this meeting the TAG were provided with an overview of the Consultation Paper responses. An approach to developing guidance based on this feedback and taking into consideration the latest IASB proposals arising from its Primary Financial Statements Project was proposed.
- 2.2 Since the May 2023 meeting, draft authoritative guidance has been developed. The key features of this guidance have been the subject of a focus group that was held in August and have also been shared with the PAG for their feedback earlier this month. Updates to IASB proposals at its recent meetings have also been considered in drafting the authoritative guidance.
- 2.3 The draft authoritative guidance is included in Annex A.

### 3. Classification methods, allocation and aggregation of expenses and factors to consider

- 3.1 The proposed guidance permits an NPO to provide an analysis of expenses using a classification based on either the nature of expenses, the function of expenses within the NPO, or a mixed presentation (that is partly natural expenses and partly functional expenses), whichever provides information that is reliable and more relevant to the users of the financial statements.

This analysis shall be presented in the Statement of Income and Expenses or the notes.

- 3.2 Analysis by nature of expense would provide information about expenses arising from the inputs that are consumed to accomplish an NPO's activities. Under this method of classification, expenses are aggregated in the Statement of Income and Expenses according to their nature (for example, depreciation, purchases of materials, transport costs, and employee benefits) without reference to how expenses are allocated to functions within the NPO.
- 3.3 Analysis by function of expense would allocate and combine expenses according to the activity to which the item relates. For example costs of fundraising could be a functional line item that combines expenses related to the NPOs revenue generating activities such as employee costs or advertising costs. Other functional line items could include major operational programmes or administrative support activities. Where an NPO presents functional line items it is proposed that it shall also disclose a narrative description of the material expense types based on their nature, that are included in each functional line item.
- 3.4 Analysis using a mixed presentation would allow both analysis by nature and analysis by function to be combined in a single presentation format. Using this method of classification, expenses are aggregated in the Statement of Income and Expenses partly according to their nature and partly according to their function. It is important to note that this is not a matrix approach where all expenses would be shown from both a natural and functional perspective. Again where an NPO presents functional line items as part of a mixed presentation it is proposed that it shall also disclose a narrative description of the material expense types based on their nature that are included in each functional line item.
- 3.5 Given the diversity of NPOs and different information needs of users, providing NPOs with the freedom to select the classification method is important to ensure that the information provided is reliable and is most relevant to users.
- 3.6 Disclosing information about the material expenses types by nature that are included in functional line items will provide users with information about the nature of expenses that might otherwise not be visible. A narrative rather than quantitative approach is deemed appropriate to balance the needs of users with the costs of preparers in providing this additional information.



**Question 1: Do TAG members consider that (a) NPOs should be permitted to provide an analysis of expenses using a classification based on either the nature of expenses, the function of expenses within the NPO, or a mixed presentation and (b) that this analysis be presented in the Statement of Income and Expenses or the notes?**

**Question 2: Where an analysis by function of expense or mixed presentation is chosen, should an NPO also be required to disclose a narrative description of what types of expenses based on their nature are included in each functional line item?**

- 3.7 As analysis by function of expense and analysis by mixed presentation involves allocating and aggregating some or all expenses to the activity to which the consumed resource relates. To assist NPOs, the proposed authoritative guidance also provides principles on attributing costs to activities for this purpose.
- 3.8 It notes that NPOs should ensure that the methods of allocating and aggregating expenses should be reasonable and consistently applied and consistent between reporting periods unless circumstances change.
- 3.9 It also notes that in attributing costs to activities, NPOs shall identify cost as either:
- (i) direct costs – costs that are attributable solely to providing an individual service, good, programme or similar activity in pursuit of the NPO’s stated mission or objectives;
  - (ii) shared costs - costs that are attributable to providing more than one service, good, programme or activity in pursuit of the NPO’s stated mission or objectives; or
  - (iii) support costs – costs that are not attributable to providing services and goods or otherwise carrying out programme and similar activities in pursuit of the NPO’s stated mission or objectives.
- 3.10 In making this identification an NPO shall apply the following general principles:
- Direct costs attributable to an activity must be allocated directly to that activity (for example the salary cost of someone solely employed on a particular activity or the cost of running a vehicle used wholly for a particular activity);
  - Shared costs which contribute directly to more than one activity must be apportioned between those activities (for example the cost of a

staff member whose time is divided between a fundraising activity and working on the delivery of a programme); and

- Support costs which are not attributable to a single activity must be apportioned between the activities being supported (for example the cost of a staff member working in a central finance department).

- 3.11 The proposed application guidance indicates that NPOs can balance the benefits of greater accuracy with the costs involved in preparing and maintaining information when selecting methods of apportioning costs. It also provides examples of bases for apportionment including:
- usage of a resource or activity in terms of time taken, capacity used, or requests made;
  - per capita, based on the number of people employed within an activity;
  - floor area occupied by an activity; or
  - time, where staff duties span more than one activity.

**Question 3: Do TAG members consider that the principles on attributing and apportioning costs included in the authoritative guidance are sufficient?**

- 3.12 To assist NPOs in determining which method of expenses analysis will provide the most useful information, the proposed application guidance also includes a number of factors that should be considered.
- 3.13 These factors which are based on the proposed guidance being developed as part of the IASB's Primary Financial Statements project include:
- a) which method provides the most useful information to users of financial statements about key components of the NPO's surplus or deficit;
  - b) which method most closely represents the way the NPO is managed and how management reports internally;
  - c) sector practice - the use of similar methods for an analysis of expenses would enable users to more easily compare expenses across entities in the same sector; and
  - d) whether the allocation of expenses to functions would be arbitrary and therefore would not provide a sufficiently faithful representation of the line items presented. In such cases, the nature of expense method shall be used.
- 3.14 There may be occasions where a mixed presentation can provide the most useful information to users. For example an NPO with two or more distinct types of activities may present some of its expenses by function and others

by nature, to provide information about the key components of surplus or deficit.

- 3.15 A mixed presentation is also the expected format for the Supplementary Statement, which combines natural expense items such as grants payable and travel and subsistence with functional items such as support costs. Options for the Supplementary Statement will be considered further at this meeting, but NPOs that choose to present an optional segmental analysis or otherwise prepare one or more Supplementary Statements could consider the use of the Supplementary Statement format for their expenses analysis in the Statement of Income and Expenses or notes. It should be noted that the Supplementary Statement includes additional information such as capital costs funded through grants and donations and not just an expenses analysis. A mixed presentation would not therefore necessarily replace the benefits of supplementary information, but could simplify reporting requirements for an NPO.

**Question 4: Do TAG members consider that the factors that should be considered by NPOs when determining the method of expenses analysis included in the authoritative guidance are sufficient?**

#### 4. Mandatory disclosures and IASB developments

- 4.1 Allowing a choice of method may lead to significant inconsistencies in the information provided by NPOs, even where the NPOs are similar in nature. To address this possibility consideration has been given to minimum expense information to be included in the financial statements.
- 4.2 Therefore, regardless of the classification method utilised, it is also proposed that at a minimum an NPO will disclose in the notes a number of other expenses if not already presented in the Statement of Income and Expenses or notes, as part of the analysis of expenses.
- 4.3 The minimum disclosure would require certain prescribed information of all NPOs however they choose to classify their expenses. These are:
- 4.4 ***Expenses related to key management personnel*** - Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the NPO, directly or indirectly. In the NPO context this may include trustees, directors and others who are charged with governance. Some key management personnel may receive

compensation for carrying out these roles. Section 33 *Related Parties* requires disclosure of compensation of key management personnel in total. Complying with the requirements of Section 33 is expected to be sufficient to provide transparency over such expenses.

- 4.5 ***Employee remuneration and other related expenses including volunteers*** - Employee remuneration shall include all remuneration paid to employees of the NPO and all other costs directly related to their employment. This shall include short-term employee benefits, post-employment benefits, other long-term benefits and terminations benefits as defined in Section 28 Employee benefits. Where volunteers receive benefits such as free or subsidised services or goods, it is proposed that these shall be included in this disclosure. Where compensation is paid to key management personnel, this shall not be included in this disclosure as it will already be disclosed in accordance with Section 33.
- 4.6 ***Expenses on grants and donations*** - Expenses on grants and donations shall be calculated and disclosed in accordance with Section 24 Part I Expenses on grants and donations. This will require information on the nature, amount, timing and uncertainty of expenses and related assets and liabilities. NPOs will also be required to disclose total expenses on enforceable grant arrangements (EGAs), expenses on other funding arrangements (OFAs).
- 4.7 ***Ex-gratia payments*** - An ex-gratia payment is a payment, or the waiver of a right to an asset, which those charged with governance of the NPO have no legal obligation or legal power to make, but which they believe they have a moral obligation to make. It is proposed that NPOs must disclose details of all ex-gratia payments made including those where the NPO has obtained authority to make the payments from a court, regulator or similar body. NPOs may aggregate payments of a similar nature where this does not impact on the understanding of the transactions. For each payment (or in aggregate) the notes to the accounts must:
- provide an explanation of the nature of the payment;
  - state the legal authority or reason for making the payment; and
  - state the amount of the payment (or value of any waiver of a right to an asset).
- 4.8 ***Expenses related to fundraising*** - Expenses related to fundraising should be calculated and disclosed in accordance with Section 24 Part III Fundraising costs. These proposals are included in TAGED 14-02 and include a requirement to provide a narrative description of the method of cost allocation and bases of apportionment adopted to calculate fundraising costs

and individual numerical disclosures around commercial trading and other material components of fundraising costs.

- 4.9 **Total expenses on programme activities** - Total expenses on programme activities will include all direct and shared costs attributable to providing services and goods or otherwise carrying out programme and similar activities in pursuit of the NPO's stated mission or objectives. This is called programme activities for brevity. An NPO may in addition to total expenses on programme activities present a programme analysis that shows the main activities that comprise these expenses. Where an NPO presents information via a programme analysis, the NPO shall describe the basis for preparing and presenting the information. Where an optional segmental analysis has been prepared this disclosure may be incorporated into that analysis.
- 4.10 **Total expenses on support activities** - Total expenses on support activities will include all support costs that are not attributable to providing services and goods or otherwise carrying out programme and similar activities in pursuit of the NPO's stated mission or objectives. Again where an optional segmental analysis has been prepared this disclosure may be incorporated into that analysis.
- 4.11 These proposed minimum disclosure requirements were discussed with the PAG at its meeting earlier this month. They were of the view that these disclosures looked appropriate for NPOs. They did not suggest any additional disclosures.

**Question 4: Do TAG members consider these mandatory disclosures appropriate to ensure the consistency of key information?**

- 4.12 Finally the Secretariat notes that the IASB as part of its financial statements project is considering the potential of requiring additional mandatory natural expense disclosures where an entity utilises a functional or mixed classification approach.
- 4.13 For each functional line of expenses included in the statement of profit or loss this would require the disclosure of:
- Depreciation
  - amortisation,
  - employee benefits,
  - impairments, and
  - write-down of inventory
- 4.14 The IASB has provided an example of how this might look below:





Operating expenses by nature		Tab 1
(in currency units)	20X2	20X1
<b>Depreciation</b>	<b>175</b>	...
Cost of goods sold	100	...
General and administrative expenses	25	...
Research and development expenses	50	...
<b>Amortisation</b>	<b>100</b>	...
Research and development expenses	100	...
<b>Employee benefits</b>	<b>375</b>	...
Cost of goods sold	150	...
Selling expenses	100	...
General and administrative expenses	50	...
Research and development expenses	75	...
<b>Impairments</b>	<b>80</b>	...
Research and development expenses	80	...
<b>Write-downs of inventory</b>	<b>50</b>	...
Cost of goods sold	30	...
Other operating expenses	20	...

- 4.15 The proposed authoritative guidance does not include this requirement. A narrative description of what types of expenses based on their nature that are included in each functional line item is deemed sufficient where a functional or mixed presentation is utilised.

**Question 5: Do TAG members consider that where an NPO utilises a functional or mixed classification approach the additional mandatory natural expense disclosures proposed by the IASB are appropriate?**

## 5. Next steps

- 5.1 The proposed guidance will be updated based on TAG member feedback and brought to future meetings ahead of finalisation for Exposure Draft 3 along with the Implementation Guidance and Basis for Conclusions.

September 2023

## Annex A – Draft Authoritative Guidance

---

### Section 24 – Expenses - Part II *Classification of expenses*

---

#### Scope

G24.42 This Section specifies the requirements for an analysis of expenses that an NPO shall present in accordance with G5.11.

#### Classification methods

G24.43 An NPO shall provide an analysis of expenses using a classification based on either the nature of expenses, the function of expenses within the NPO, or a mixed presentation (with part natural expenses classification and part functional classification), whichever provides information that is reliable and more relevant to the users of the financial statements. This analysis shall be presented in the Statement of Income and Expenses or in the notes to the financial statements.

##### *Analysis by nature of expense*

G24.44 The nature of expense method provides information about expenses arising from the inputs that are consumed to accomplish an NPO's activities. Under this method of classification, expenses are aggregated in the Statement of Income and Expenses according to their nature (for example, depreciation, purchases of materials, transport costs, employee benefits and advertising costs) without reference to how expenses are allocated to functions within the NPO.

##### *Analysis by function of expense*

G24.45 The function of expense method allocates and combines expenses according to the activity to which the item relates. For example costs of fundraising is a functional line item that combines expenses related to the NPOs revenue generating activities such as: depreciation, purchase of materials, transport costs, employee benefit costs or advertising costs. Other functional line items could include major operational programmes or administrative support activities. Where an NPO presents functional line items it shall disclose a narrative description of what types of expenses (based on their nature) are included in each functional line item.

##### *Analysis by mixed presentation*

G24.46 The mixed presentation method combines analysis by nature and analysis by function. Under this method of classification, expenses are aggregated in the Statement of Income and Expenses partly according to their nature and partly according to their function. Where an NPO presents functional line items as part of a mixed presentation it shall

disclose a narrative description of what types of expenses (based on their nature) are included in each functional line item.

### **Allocation and aggregation of expenses**

G24.47 Analysis by function of expense and analysis by mixed presentation involves allocating and aggregating some or all expenses to the activity to which the consumed resource relates. NPOs shall ensure that the methods of allocating and aggregating expenses are reasonable and consistently applied and consistent between reporting periods unless circumstances change. NPOs shall select a method that ensures that the accounts present the costs of activities fairly.

G24.48 In attributing costs to activities, NPOs shall apply the following general principles:

- a) Direct costs attributable to an activity must be allocated directly to that activity (for example the salary cost of someone solely employed on a particular activity or the cost of running a vehicle used wholly for a particular activity);
- b) Shared costs which contribute directly to more than one activity must be apportioned between those activities (for example the cost of a staff member whose time is divided between a fundraising activity and working on the delivery of a programme);
- c) Support costs which are not attributable to an activity must be apportioned between the activities being supported (for example the cost of a staff member working in a central finance department).

### **Disclosures**

G24.49 Regardless of the classification method utilised, at a minimum an NPO shall also disclose the following expenses if not already presented in the Statement of Income and Expenses or the notes:

- a) Expenses related to key management personnel
- b) Employee remuneration and other related expenses including volunteers
- c) Expenses on grants and donations
- d) Ex-gratia payments
- e) Expenses related to fundraising
- f) Total expenses on programme activities
- g) Total expenses on support activities

#### ***Expenses related to key management personnel***

G24.50 Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the NPO, directly or indirectly. In the NPO context this may include trustees, directors and others who are charged with governance. Some key management personnel may receive compensation for carrying out these roles. Any compensation paid to key management personnel shall be disclosed in accordance with paragraphs G33.6-G33.7 of Section 33 *Related party disclosures*.

***Employee remuneration and other related expenses including volunteers***

G24.51 Employee remuneration shall include all remuneration paid to employees of the NPO and all other costs directly related to their employment. This shall include short-term employee benefits, post-employment benefits, other long-term benefits and terminations benefits as defined in Section 28 *Employee benefits*. Where volunteers receive benefits such as free or subsidised services or goods these shall also be separately presented as part of this disclosure.

G24.52 Where compensation is paid to key management personnel, this shall not be included in this disclosure but separately disclosed as per paragraph G24.50.

***Expenses on grants and donations***

G24.53 Expenses on grants and donations should be calculated and disclosed in accordance with Section 24 Part I *Expenses on grants and donations*. NPOs are also be required to disclose total expenses on:

- a) enforceable grant arrangements (EGAs); and
- b) other funding arrangements (OFAs);

***Expenses related to fundraising***

G24.54 Expenses related to fundraising should be calculated and disclosed in accordance with Section 24 Part III *Fundraising costs*.

***Ex-gratia payments***

G24.55 An ex-gratia payment is a payment, or the waiver of a right to an asset, which those charged with governance of the NPO have no legal obligation or legal power to make from the NPO's funds but which they believe they have a moral obligation to make.

G24.56 NPOs must disclose details of all ex-gratia payments made including those where the NPO has obtained any authority to make the payments from a court, regulator or similar body. NPOs may aggregate payments of a similar nature where this does not impact on the understanding of the arrangement. For each payment (or aggregation of payments) the notes to the accounts must:

- a) provide an explanation of the nature of the payment;
- b) state the legal authority or reason for making the payment; and
- c) state the amount of the payment (or value of any waiver of a right to an asset).

***Total expenses on programme activities***

G24.57 Total expenses on programme activities will include all direct and shared costs attributable to providing services and goods or otherwise carrying out programme and similar activities in pursuit of the NPO's stated mission or objectives. Where an NPO has prepared an option segmental analysis in accordance with G37.XX this disclosure can be incorporated into that analysis.

G24.58 An NPO may in addition to total expenses on programme activities present a programme analysis of the main activities that comprise these expenses. Where an NPO presents information via a programme analysis, the NPO shall describe the basis for preparing and presenting the information in accordance with G3.24. Where the programme analysis is included in the optional segmental analysis prepared in accordance with G37.XX this disclosure can be incorporated into that analysis.

### ***Total expenses on support activities***

G24.59 Total expenses on support activities will include all support costs that are not attributable to providing services and goods or otherwise carrying out activities in pursuit of the NPO's stated mission or objectives. Where an NPO has prepared an option segmental analysis in accordance with G37.XX and has included support costs this disclosure can be incorporated into that analysis.

---

## **Application guidance**

---

### **Determining which method of classification to provide an analysis of expenses**

AG24.45 G24.43 requires an NPO to provide an analysis of expenses using a classification based on either the nature of expenses, the function of expenses within the NPO, or a mixed presentation, whichever provides information that is reliable and more relevant to the users of the financial statements.

AG24.46 An NPO shall consider, in deciding, which method of expense analysis provides the most useful information:

- (a) which method provides the most useful information to users of financial statements about key components of the NPO's surplus or deficit. For example, for an NPO that primarily generates revenue through retail activities before distributing surpluses to local good causes, a key component of surplus or deficit could be costs of sales. Presenting a cost of sales line item can provide relevant information about whether the revenue generated from the sale of goods covers direct costs associated with those sales and by what margin. However, presenting a costs of sales line item is unlikely to provide relevant information when the link between revenue and costs is less direct. For example if the same NPO instead primarily generated revenue through returns on capital endowments, information about the expenses presented using a nature of expense analysis, such as investment costs, may be more relevant to users.
- (b) which method most closely represents the way the NPO is managed and how management reports internally. For example, an international humanitarian NPO managed on the basis of major functions such as emergency response, long-term humanitarian programmes, and governmental lobbying and legal activities, might use a function of expense method for internal reporting. However, an NPO that has a single predominant function, such as medical research related to an individual disease, may find a more detailed analysis of expenses using a nature of expense method provides more useful information.

- (c) sector practice. The use of similar methods for an analysis of expenses would enable users to more easily compare expenses across entities in the same sector.
- (d) whether the allocation of expenses to functions would be arbitrary and therefore would not provide a sufficiently faithful representation of the line items presented. In such cases, the nature of expense method shall be used.

AG24.47 There may be occasions where a mixed presentation can provide the most useful information to users. For example, an NPO with two or more distinct types of activities may present some of its expenses by function and others by nature, to provide information about the key components of surplus or deficit. As noted in G24.46, where an NPO presents functional line items as part of a mixed presentation it shall disclose a narrative description of what types of expenses (based on their nature) are included in each functional line item.

### **Cost allocation**

AG24.48 NPOs can balance the benefits of greater accuracy with the costs involved when selecting methods of apportioning costs. Examples of bases for apportionment that may be applied include:

- usage of a resource or activity in terms of time taken, capacity used, or requests made;
- per capita, based on the number of people employed within an activity;
- floor area occupied by an activity; or
- time, where staff duties span more than one activity.