



Technical Advisory Group Issue Paper

AGENDA ITEM: TAGED16-02
12 December 2023 – Online

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

Summary	The paper provides TAG members with an updated draft of the authoritative guidance for Section 24 Part II <i>Classification of expenses</i> . It reflects amendments made as a result of members views expressed at the September 2023 meeting.
Purpose/Objective of the paper	At the September 2023 TAG meeting, members were provided with a draft of the authoritative guidance for Section 24 Part II <i>Classification of Expenses</i> . Following discussion at that meeting, the Secretariat has made amendments to the draft guidance. This includes (i) the introduction of a rebuttable presumption that the most reliable and relevant information to users will be provided by a natural classification and (ii) the removal of requirements related to supplementary information, with these requirements set out in Section 37 <i>Supplementary information</i>
Other supporting items	TAGED16-03 <i>Fundraising Costs</i> , TAGED16-04 <i>Supplementary Information</i>
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Actions for this meeting	Comment and advise on the: <ul style="list-style-type: none">• changes made to introduce a rebuttable presumption that a natural classification will provide the most reliable and relevant information to users;• changes related to the provision of whole of entity information based on Supplementary Statement expense categories; and• other more minor amendments.

Technical Advisory Group

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

1. Introduction

- 1.1 This paper provides an overview of :
- the changes made to classification methods to introduce a rebuttable presumption that a natural classification will provide the most reliable and relevant information to users;
 - changes related to the provision of whole of entity information based on Supplementary Statement expense categories where the NPO produces one or more Supplementary Statements; and
 - other more minor amendments.

2. Background

- 2.1 At the September 2023 TAG meeting, members were provided with an initial draft of authoritative guidance for Section 24 Part II Classification of Expenses. This guidance was based on feedback from respondents to the proposal in the Consultation Paper, the latest IASB proposals arising from its Primary Financial Statements Project, a focus group that was held in August, and feedback from the PAG.
- 2.2 The draft guidance was based on a proposal that an NPO 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.
- 2.3 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, the proposed authoritative guidance included principles on attributing costs to activities for this purpose.
- 2.4 Finally, as allowing a choice of method could lead to differences in the information provided by NPOs, even where the NPOs are similar in nature, a number of mandatory disclosures were also proposed to provide a base level of comparability.

3. Natural expense classification rebuttable presumption

- 3.1 TAG members expressed concern that the freedom 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 would not support comparability. As such it was felt that a single method of expense classification should be promoted even if the presentation under that method was not prescribed.
- 3.2 As most NPOs would be expected to utilise accounting software that would most easily permit the production of general purpose financial statements using a natural classification, and as there would also be expected to be significantly less diversity between natural classification categories compared to functional categories, it was agreed that this single method would be a natural classification of expenses.
- 3.3 As such the guidance has been amended to note that while a classification based on the nature, the function, or a mixed presentation is permitted, there is a rebuttable presumption that the most reliable and relevant information to users will be provided by a natural analysis of expenses. If the presumption is rebutted, and a classification based on the function of expenses or a mixed presentation is used, the guidance requires an explanation by way of a note as to why this provides information that is reliable and more relevant to users.

Question 1: Are TAG members content with the introduction of the rebuttable presumption that the most reliable and relevant information to users will be provided by a classification based on the nature of expenses?

4. Whole of entity information based on Supplementary Statement expense categories

- 4.1 The relation between the classification of expense analysis, some of the additional mandatory disclosures including programme and support expenses, and the potential requirement to also disclose Supplementary Statement expense categories was also discussed at the September 2023 and November 2023 meetings.
- 4.2 Views were expressed that requiring these mandatory disclosures could be a significant burden if applicable to all entities. The proposals have therefore been amended so that additional whole of entity information using the

Supplementary Statement expense categories will only be required if an NPO is preparing one or more Supplementary Statements in accordance with the Recommended Practice Guide.

- 4.3 This would provide a bridge between audited whole of entity figures included in the general purpose financial statements and those included by the NPO in Supplementary Statements related to individual projects, programmes or grants. Where an NPO does not prepare one or more Supplementary Statements, it is proposed that while these disclosures would be permitted they would not be mandatory.
- 4.4 The Secretariat considers that this proposal provides an appropriate balance between the needs of users and ensuring that the proposals for the disclosure of expenses is not overly burdensome on NPOs. Authoritative guidance on the inclusion of Supplementary Information will be contained within Section 37 *Supplementary Information* of INPAG.

Question 2: Do TAG members support the changes to mandatory disclosure of information related to Supplementary Statement expense categories and expenses related to programme and support activities?

5. Other mandatory disclosures and additional amendments to consider

- 5.1 Mandatory disclosures related to key management personnel, employee remuneration, expenses on grants and donations, and expenses related to fundraising are required, are still proposed. These disclosures mainly reflect existing disclosure requirements in other Sections (e.g. Section 33 *Related Party Disclosures*). However, some proposed mandatory requirements are incremental changes that go beyond the scope of existing disclosures (e.g. the addition of volunteer benefits to employee remuneration disclosures required by Section 28 *Employee Benefits*).
- 5.2 Repetition can be reduced by amending disclosures in these Sections rather than including them in Section 24 Part II. As such it is proposed that Section 24 Part II includes only disclosure requirements that are not included in other Sections. These are (i) benefits received by volunteers and related expenses and (ii) losses, write-offs and special payments (previously ex-gratia payments).
- 5.3 Where application guidance for the NPO context is required for existing disclosure requirements, such as what constitutes key management

personnel for Section 33 *Related Party Disclosures*, this will be included in the relevant Section.

Question 3: Do TAG members agree that the mandatory disclosures related to key management personnel, employee remuneration, expenses on grants and donations, and expenses related to fundraising not be duplicated in Section 24 Part II, with application guidance included where required in the relevant Section?

- 5.4 The mandatory disclosure on ex-gratia payments has been expanded to include losses, write-offs and special payments in line with feedback from TAG members. These are a range of expenses that are deemed to be outside of what would be expected to be the normal activities of an NPO. While it is not possible to provide an exhaustive list of expenses that could be included in this disclosure, examples are included to assist NPOs in applying judgement.

Question 4: Do TAG members support the replacement of the ex-gratia payment disclosure with one covering all losses, write-offs and special payments?

- 5.5 In addition, a number of more minor amendments have also been made. This includes to the general principles for the allocation and aggregation of expenses. These have been retained but a change to the guidance has been made to note that Support costs may be apportioned between the activities that they support. This provides NPOs with the option of disclosing these costs separately rather than requiring it.
- 5.6 It is therefore not proposed that Support costs be a mandatory disclosure. Only where an NPO prepares one or more Supplementary Statements (where expenses related to support activities are disclosed separately) would whole of entity information on Support costs be required.
- 5.7 To minimise burdens no further mandatory disclosures in addition to those already included in another Section are proposed for inclusion in Section 24 Part II. The Secretariat considered other items such as audit related disclosures, which would show the amount of resource used on audit and could indicate the scale of audit activities as well as potential conflicts with non-audit activities provided by the same supplier. To minimise disclosure burdens, these were not proposed for inclusion now, but should be considered in later iterations of INPAG.



Question 5: Do TAG members have any comments on the changes related to support costs in the allocation and aggregation principles?

Question 6: Do TAG members agree that no further mandatory disclosures in addition to those already included in another Section be proposed for inclusion in Section 24 Part II?

6. Next steps

- 6.1 The proposed guidance will be updated based on TAG member feedback and reshared ahead of finalisation for Exposure Draft 3 along with the Basis for Conclusions.

December 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.

G24.44 There is a rebuttable presumption that the most reliable and relevant information to users will be provided by an analysis of expenses using a classification based on the nature of expenses. If the presumption is rebutted and a classification based on the function of expenses within the NPO or a mixed presentation is used, an NPO must explain by way of a note why this provides information that is reliable and more relevant to the users of the financial statements.

Analysis by nature of expense

G24.45 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 employment costs, travel and subsistence, supplies and materials, external services) without reference to how expenses are allocated to functions within the NPO.

Analysis by function of expense

G24.46 The function of expense method allocates and combines expenses according to the activity to which the item relates. For example costs of distributing humanitarian aid could be a functional line item that combines expenses related to employment costs, travel and subsistence, supplies and materials, external services. Other functional line items could include major operational programmes or administrative support activities, whatever is most relevant to the NPO. 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

G24.47 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

G24.48 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.

G24.49 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, while essential for the NPOs activities to be carried out, are organisation wide and hence not directly attributable to one or more activities may be apportioned between the activities being supported (for example governance costs) or disclosed separately.

Disclosures

G24.50 In addition to the analysis of expenses, an NPO shall disclose, if not already presented in the Statement of Income and Expenses or the notes:

- a) Benefits received by volunteers
- b) Losses, write-offs and special payments

Benefits received by volunteers

G22.53 Where volunteers receive benefits such as free or subsidised services or goods, these shall be disclosed separately from employee benefit disclosures required by Section 28 *Employee Benefits*.

G24.54 Where volunteers are part of key management personnel, these benefits shall not be included in this disclosure but separately disclosed as per paragraph G33.6 of Section 33 *Related Party Transactions*.

Losses, write-offs and special payments

G24.57 Losses, write-offs and special payments relate to a range of expenses that are outside of the normal activities of an NPO. Given the different nature of NPOs activities, it is not possible to provide an exhaustive list of the expenses that may be included in this disclosure. Judgement shall be applied by an NPO to determine whether the substance of an expense means it should be included in this disclosure.

G24.58 Losses and write-offs include expenses arising from cash losses, unrecoverable overpayments, losses from fraud, theft, arson or other deliberate acts, fruitless payments, constructive losses, claims waived or abandoned and similar items.

G24.59 Special payments include extra-contractual payments, payments to contractors outside of a binding contract, compensation payments, special severance payments, and payments 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.

G24.60 NPO's must disclose details of losses, write-offs and special payments made including those where the NPO has been required to obtain authority to make payments from a court, regulator or similar body. NPOs may aggregate losses, write-offs and special payments of a similar nature where this does not impact on users understanding. For each loss, write-off or special payment (or aggregation) the notes to the accounts must state the amount and provide an explanation of the nature of the loss, write-off or special payment and the reason why it occurred.

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. There is a rebuttable presumption in G24.44 that the most reliable and relevant information to users will be provided by an analysis of expenses using a classification based on the nature of expenses.

AG24.46 In determining whether to rebut the presumption, an NPO shall consider, in deciding, which method of expense analysis provides the most useful information:

- (a) which method provides the most useful and reliable 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 G24.47, 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.



Implementation guidance

Cost allocation

IG24.1 NPOs will need to balance the benefits of greater accuracy with the costs involved when selecting methods of apportioning costs. A method should be reflective of the likely use of resources and made with reference to a quantifiable base.

IG24.2 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.

IG24.3 A measurement base that takes account of floor area might be suitable for the apportionment of utilities, whereas a measurement base that takes account of the number of people employed within an activity might be useful for certain IT costs.

Illustrative example

NPO A occupies an office building on a long-term lease. The lease provides for a payment of CU1,000 per month. Monthly lease costs are allocated, based on square metres occupied, to the NPOs activities as follows:

Direct costs the costs of space occupied by staff whose salaries are charged directly to an activity are charged directly to that activity.

Support costs the costs of space occupied by staff whose salaries are not directly charged to activities are apportioned to those activities proportionally based on the percentage of the NPOs operational budget those activities comprise.

25 percent of the floor space is occupied by staff whose salaries are charged to Activity A, 25 percent of the floor space is occupied by staff whose salaries are charged to Activity B and the remaining 50 percent of the floor space is occupied by support staff. Activity A is 20 percent of the NPOs operational budget and Activity B is 80 percent.

Activity A is allocated CU350 of the monthly lease expense - CU250 of direct costs and CU100 of support costs ($500 \times 20\%$)

Activity B is allocated CU650 of the monthly lease expense - CU250 of direct costs and CU400 of support costs ($500 \times 80\%$)