FINANCIAL REPORTING FOR NOT FOR PROFIT ORGANISATIONS (NPOS)

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Definition

- Not-for-Profit Organisations (NPOs) are also often referred to as “Development Organisations”, “Private Voluntary Organisations”, “Civil Society Organisations” “Non Governmental Organisations”, “Non-Profit Organisations”, “Charities” and other similar terms (Public Benefit Organizations).
The requirement to register under a statute may apply to all charities and humanitarian agencies. They can also be registered under Public Benefit Organization Act, Companies Act and Trust law.
Definition drawn from the World Bank

“The World Bank uses the term Civil Society to refer to the wide array of non-governmental and non-profit organizations that have a presence in public life, expressing the interests and values of their members or others, based on ethical, cultural, political, scientific, religious or philanthropic considerations. Civil Society Organizations (CSOs) therefore refer to a wide array of organization: community groups, non-governmental organizations (NGOs), labour unions, indigenous groups, charitable organizations, faith-based organizations, professional associations, and foundations.”
Common Features

- **Voluntary** – either local to a particular area, national or international
- With specific objectives **to the benefit of society in general**, or a particular vulnerable group of society, or an identified interest or target groups
- Objectives are **not profit oriented**
- **No ownership interests** - Receive financial support for promotion of the organisation’s objectives
Promotion of self-regulation

- Sect 28 (1) The Commission shall encourage umbrella associations for public benefit organisations to develop and publish codes of conduct applicable to members, governing body officials, staff and volunteers of the public benefit organizations.

- (2) The Commission shall facilitate training on self-regulation of public benefit organization to deepen the knowledge and strengthen the capacity of public benefit organizations for self-regulation
Sect 29. Every public benefit organisation registered under this Act shall—

- Implement internal accounting and administrative procedures necessary to ensure the transparent and proper use of its financial and other resources;
- Utilise its financial and other resources for the attainment of its aims, objects and purposes.
30. (1) Every public benefit organisation registered under this Act shall keep proper books of accounts and other records in relation to its operations and activities and shall, subject to subsection (2), prepare annually a statement of accounts in a form which conforms to the standards of the generally accepted accounting practice applicable to non-profit organizations.

(2) The financial statements prepared and submitted by a public benefit organization, shall include an opinion signed by an independent audit as to whether the financial statement presented fairly in all material respects, the organization financial position for the year ended.
31. Within six months after the end of each financial year, every public benefit organisation registered under this Act shall cause to be made and submitted to the Commission—

a) A statement of its accounts audited in accordance with section 31 above;

b) A certified copy of its financial statements;

c) A report dealing generally with the programme of activities of the public benefit organisation during that financial year.
Objectives and Activities

- The Annual Report should help the reader understand the aims and objectives set by the organization, and the strategies and activities undertaken to achieve them. The report may also, where relevant, explain how the objectives set for the year relate to longer term strategies and objectives set by the organization.

- A summary of the objects of the PBO as set out in its governing document.

- An explanation of the PBO’s aims including the changes or differences it seeks to make through its activities.
Annual Report

- An explanation of the PBO’s main objectives for the year.
- An explanation of the PBO’s strategies for achieving the stated objectives.
- A review of the significant activities (including its main programmes, projects or services provided) undertaken by the PBO to further its charitable purposes for the public benefit. The details provided should focus on the activities that the Directors consider significant in terms of the PBO as a whole. The Annual Report should, as a minimum, explain the objectives, activities, projects or services identified within the analysis note accompanying the charitable activities set out in the Statement of Financial Activities (SoFA).
The following International Accounting Standards (IASs)/International Financial Reporting Standards (IFRSs) have been identified as being relevant to Non-for-Profit Organizations. The requirements of these IASs have been considered and amended to suit the operations and transactions of these organizations. The relevant International Accounting Standards are as indicated in the following table.
Some underlying principles to be considered

The principles of recognition and measurement should generally be retained while provisions with regard to disclosure may need to be reduced.

Fundamental recognition of the fact that the financial structure of and the activities of NPOs are different from that of a commercial enterprise.

1. No ownership interest: no requirement for a return on investment.
2. Information on usage of funds is to verify efficiency of management and equity of projects: no reference to cost or servicing of debt and equity.
3. Emphasis on transparency of management, equity of projects: striking a balance between transparency and accountability; and
4. Optimum use of limited resources available, inclusive of capacity of staff to implement the standards.
Principles in Financial Reporting

- Fair presentation – ensure that the presentation of factual information represents the reality of the organisation’s situation – eg. A debt shown in the balance Sheet may be real and numerically correct, but is it ever going to be recovered?

- Accounting policies – explain the accounting methods chosen for items such as depreciation, asset valuation, foreign exchange conversion, recognition of income

- Going concern – assets are valued on the basis that the organisation can continue its activities for the foreseeable future

- Accrual basis of accounting – apply income and expenditure to the period when they were incurred, rather than when they were paid. NGO’s especially need to apply the accrual concept to grant income.
Principles in Financial Reporting

- Consistency of presentation – apply accounting policies consistently from one year to the next so that results are comparable
- Materiality and aggregation – ensure that significant items are shown separately but avoid unnecessary detail
- Offsetting – ensure that sufficient detail is shown in the financial statements where opposite types of transaction are passed through the same account and are deducted from each other (e.g. the balance on a loan is made up of the initial advance, plus interest, less repayments. It may be relevant to disclose all the components)
The majority of the International Accounting Standards /International Public Sector Accounting Standards would be applicable to the NPO sector, with some adjustment particularly with regard to disclosure. Some standards may need to be interpreted differently, given the workings of an NPO. Some are industry related and would not therefore relate to an NPO. Others may contain a level of sophistication which, given the limited resources available to an NPO, could be counter productive.
Not for Profit Organisations: Issues in Applicability of different Accounting Standards

- IFRS 1: First-time Adoption of International Financial Reporting Standards
- An entity’s first set of financial statements are required to present at least three statements of financial position and two statements each of statements of comprehensive income, income statements (if presented), statements of cash flows and statements of changes in equity, related notes and in relation to the adoption of IFRSs,
A reconciliation of equity reported under previous accounting framework to equity under IFRSs:

- At the date of transition to IFRSs
- At the end of the latest period presented in the entity’s most recent annual financial Statements under previous accounting framework.

A reconciliation of total comprehensive income reported under previous accounting framework to total comprehensive income under IFRSs for the entity’s most recent annual financial statements under previous accounting framework.
In addition to the reconciliations above, the entity is also required to provide:

- A reconciliation of equity reported under its previous accounting framework to equity under IFRSs at the end of the comparable interim period, and
- A reconciliation of total comprehensive income reported under its previous accounting framework to total comprehensive income under IFRSs for the
IFRS-1

- Comparative interim period, and
- Explanations of the transition from its previous accounting framework to IFRS.
- Any errors made under the previous accounting framework must be separately distinguished
- Additional disclosure requirements are set out in IFRS 1
Not for Profit Organisations:
Issues in Applicability of different Accounting Standards

Presentation of Financial Statements – IAS 1 / IPSAS 1

- **Incoming Resources/Revenue**
  1. Government Grants, Endowments
  2. Donations and/or contributions from donor organisations or individuals
  3. Allocations from Central Headquarters overseas
  4. Interest, dividends etc from investments

- **Expenditure**
  1. Project Expenditure, direct and indirect - often inclusive of capital costs
  2. Administrative Costs
  3. Capital costs
Income Statement is the financial representation of the activities of an NPO

Need to

- Differentiate between Restricted and Unrestricted Resources and Restricted and Unrestricted Projects
- to match of income against expenditure incurred through Restricted Funds.
- to provide summary details of Direct and Indirect Project Costs
- to include project related capital costs with Project Costs in Income Statement
- To show separately other unrestricted donations, contributions, surpluses; and other administrative expenditure
Not for Profit Organisations: Issues in Applicability of different Accounting Standards

Financial Position -

Equity Statement would be the movement of funds in Restricted Funds, Unrestricted Funds, Designated Funds. There is no distribution of Profits.

Representation of Funds received

- If as a restricted fund for an identified project to be retained until utilised;
- If as an endowment, income from capital to be used as prescribed
- If a general contribution under Unrestricted funds or as designated funds, then recognise in the Income Statement on a cash basis, unless designated by the Board of Management.
- If designated, then retain until expended for designated purposed or the designation is withdrawn by the Board of Management.
- Capital Reserves arising from the capitalisation of project assets
Cash Flow Statement – IAS 7/IPSAS2

Since the usage of restricted funding is matched against income the cash flow would primarily be on account of unrestricted funds. The NPO is encouraged to use the direct method of preparing the Cash flow statement.
Not for Profit Organisations:
Issues in Applicability of different Accounting Standards

Inventories – IAS 2/ IPSAS 12

Donations may be received in kind for distribution directly to beneficiaries; or for sale and funds to be used for benefit of beneficiaries.

Any such items held by the organisation are not brought into the books; but details with quantities, value (if available) should be made available for purpose of transparency.
Not for Profit Organisations: Issues in Applicability of different Accounting Standards

- IAS 10/IPSAS 3: Accounting Policies, Changes in Accounting Estimates and Errors
- Exceptional items, Changes of accounting policy and Prior Year adjustments - IAS 8
- Separate disclosure of extraordinary items of profit or loss is required on the face of the income statement, after the total of profit or loss from ordinary activities. Such extraordinary items are rare and beyond management control.
- Items of income or expense arising from ordinary activities that are abnormal because of their size, nature or incidence are separately disclosed, usually in the notes.
- Prior year adjustments normally relate to the correction of major errors in previous accounts or significant changes in accounting policy. The adjustment is shown separately as a change to the balance brought forward on reserves. These items are not common and the important point is to show separately items that would otherwise distort the reporting of the normal income and expenditure.
Not for Profit Organisations: 
Issues in Applicability of different Accounting Standards

Post Balance Sheet Events – IAS 10/IPSAS 14

an enterprise should adjust its financial statements for events after the balance sheet date that provide further evidence of conditions that existed at the balance sheet date;

The strict application of this standard may be limited for NGOs but the principle of reviewing the value of assets and liabilities in the Balance Sheet in the light of circumstances that occur after the end of the year is highly applicable. EG: the reduction in value of debts and inventories where full recovery is in doubt.
Construction Contracts – IAS 11/IPSAS11

IAS looks at construction contracts primarily from the point of view of the contractor. The approach for an NGO must be different

**Recognition and Measurement** - Assessment on a contract by contract basis based on the stage of completion of contract

**Disclosures**

- Contracts in progress: the aggregate amount less any grants received etc.
- Gross amount due from donors and gross amount due to contractor to be shown separately
Not for Profit Organisations: Issues in Applicability of different Accounting Standards

Accounting for Taxes – IAS 12/ No IPSAS

Disparities and fluctuation between accounting profits and taxation are low

Key considerations would be:

- To simplify disclosure requirements by excluding the reconciliation of profits; and
- Eliminate the need for provisions relating to Deferred Tax.
Segment Reporting – IFRS 8/IPSAS 18

Segments could be -

- Business segments- be based on activity; or
- Geographic segments linked to location of ultimate beneficiaries.
- Emphasis for information should be on activities and locations of the entity; not for the purpose of addressing risk and return.

Areas for Segment reporting to be income, expenditure, results, funding etc. Allocation of central PPE and other assets and liabilities may not serve any purpose.

An entity may be organised and reports internally to the governing body and the senior manager on a regional basis — whether within or across national, state, local, or other jurisdictional boundaries. Where this occurs, the internal reporting system reflects a geographical segment structure.
Property Plant and Equipment - IAS 16/IPSAS 17

Key areas to be focussed on are –

- Purchases of capital items through a grant received; or a donation received of a capital item could be recognised through a deferred income account; with depreciation being set off against the element of the donation written back each year in the Income Statement and the donation set off against the asset account in the Balance Sheet.

- Where PPE is purchased as part of a project and written off to the Income Statement there is no certainty on ownership. These items need to be shown at least as a memorandum note to the Financial Statements. These assets should be brought into the books through a capital reserve at a valuation, if and when ownership reverts to the organisation.
Revenue - IAS 18/IPSAS 9

Revenue must be differentiated from Income

- Revenue for NGOs would arise from the sale of goods, rendering of services for a fee and the use by other third parties of enterprise assets (e.g. Interest earned from deposits etc.)
- Grants, donations, allocations from Head Office, Fund raisers would be the Incoming resources to be used directly for the purpose of the activities of the NPO.
- Revenue shall be measured at the fair value of the consideration received or receivable. The amount of revenue arising on a transaction is usually determined by agreement between the entity and the purchaser or user of the asset or service.
Retirement Benefit Costs – IAS 19/IPSAS 25

Liability to be based on any relevant statute, agreement or other constructive obligation as may be relevant; or any other (higher) internal requirement applicable to all employees;

- Actuarial valuation to be an alternative.
- Underlying principle: The cost of providing employee benefits shall be recognised in the period in which the benefit is earned by the employee, rather than when it is paid or payable.
Accounting for Grants and other Assistance - IAS 20

- Grants represent the main source of Income and includes assistance received from Government; donations, and for INGOs moneys received from the HQs.

- Grant received by an NPO is recognised in the Income Statement only when there is certainty of receipt and all conditions for its receipt are fulfilled; and to the extent that they match expenses that they are expected to compensate on a systematic basis.

- Where a grant has been received and there is no expectation of any future related costs, or that it be refunded to the donor, it should be recognised as income in the period in which it becomes receivable.

- Non monetary grants should be identified as a deferred asset and recognised on a systematic basis over the life of the asset.
Related Party Transactions- IAS 24/IPSAS 20

- Related parties are those able to control or exercise significant influence. Such relationships include:
  - Entities under common control.
  - Individuals who, through ownership, have significant influence over the enterprise and close members of their families.
  - Key management personnel.

For NGOs this would include Board Members, senior executives, members of their families or other businesses under their influence.

- The nature and amount of transactions with related parties should be disclosed.
IPSAS 23: Revenue From Non Exchange Transactions

An inflow of resources from non exchange transactions recognized as an asset shall be recognized as revenue, except to the extent that a liability is recognized in respect of the same flow.
Provisions and Contingencies-IAS 37/IPSAS 19

A provision should be made for liabilities that the organisation knows it will have to meet at some time but which it cannot quantify at present. Examples might include certain staff benefit funds or maintenance commitments on a rented property.

Contingencies are events that could occur in the future but where there is no certainty. In these cases no adjustment is made to the Financial Statements but a note of explanation should be given. Eg. a legal case may be in process for or against the organisation...
Investment Properties – IAS 40/IPSAS 16

RP applied to differentiate between Investment property and owner occupied premises. But thereafter measurement and valuation to be in accordance with other PPE. Provision for impairment of PPE and Investments included under the relevant sections.
Not for Profit Organisations: Issues in Applicability of different Accounting Standards

- IAS 4/IPSAS 27: Biological Assets
  - All biological assets (including those acquired biological assets through a non-exchange transaction) are measured at fair value less costs to sell, unless fair value cannot be measured reliably
  - Fair value measurement stops at harvest. IPSAS 12 applies after harvest
Intangible Assets - IAS 38/IPSAS 31

- IPSAS 31 does not apply to intangible assets acquired in an entity combination from a non-exchange transaction, and to powers and rights conferred by legislation, a constitution, or by equivalent means, such as the power to tax.

- If an intangible item does not meet both the definition and the recognition criteria for an intangible asset, expenditure on the item is recognised as an expense when it is incurred, except if the cost is incurred as part of an entity combination, in which case it forms part of the amount recognised as purchase premium/goodwill at the acquisition date.
Accounting for Investments in Associates and joint venture – IAS 28/IPSAS7- investment in associates/IPSAs 8 Joint ventures
- to be recognised in the financial statements on the equity method.

Investment in Joint Ventures – IAS 31
- JVs could be through jointly controlled activities, assets or entities
  Accounting through proportional consolidation. Equity accounting is not provided for.
The objective in standardizing financial reporting is to assist those who are responsible for the preparation of the financial statements, to improve the quality of financial reporting by NPOs, thereby providing adequate information to the users of the financial statements.

The intention is also to reduce the diversity that currently exists as among NPOs in accounting practice and presentation.

In all but exceptional circumstances, NPOs should follow the Standards in order that their accounts provide a true and fair view of the state of affairs of their organisations.
Not for Profit Organisations:
Issues in Applicability of different Accounting Standards

Objectives

- To assist those who are responsible for the preparation of the Financial Statements to improve the quality of financial reporting by NPOs.
- To reduce the diversity that currently exists among the various NPOs in accounting practices and presentation.
- To provide for transparency in the financial activities of NPOs and accountability for resources entrusted to the Management
- To ensure that adequate information is provided to the various users of these Financial Statements
Financial statements also show the results of the stewardship of management, and/or the accountability for resources entrusted to the management. Those users who wish to assess the stewardship or accountability of management do so in order that they may make economic decisions on, for example, whether or not to finance activities to be carried out by the NPO.
Financial statements meet common needs of most users. However, since the statements do not necessarily provide non-financial information, they do not contain *all* the information that users may need to make economic decisions.
Objective of Training: To assist you to avoid this!
QUESTIONS

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DISCUSSION