

# **An overview of Financial Reporting Standards in NPOs: Linkages and Possible Diversions**



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# A DIVERSE NPO SECTOR

- ▶ The feature common to all NPOs is that they are not set up to generate a return for their members. That said, NPOs can and do generate **profit** or **surplus**. However, any profit or surplus cannot be distributed to members. Beyond this common feature, the differences in legal form, size, type and objectives are numerous.
- ▶ The legal form of NPOs can be very different. Many are informal associations that are created by like-minded individuals with a common purpose, and do not take a particular legal form. These are commonly referred to as unincorporated associations.

# A DIVERSE NPO SECTOR Cont'd....

Charities form one distinct subset of NPOs, with their objectives being primarily of a charitable nature. The legal meaning of **charity** includes the charitable purposes of relieving poverty, sickness or the needs of the aged, advancing education, advancing religion and other purposes beneficial to the community. Examples that would fall within the other purposes category include providing not-for-profit childcare services, advancing arts and culture, health, promoting animal welfare and protecting the environment. An overwhelming majority of NPOs are not charities and they can exist for the exclusive benefit of members, or to serve a specific group of people, community or purpose. Examples include clubs formed for a social, recreational or sporting purpose, and professional and trade associations.

# Road Map to good financial reporting by NPOs

**The public has a right to know that charities are economical, efficient and effective in the work they do. High-quality financial reporting by charities plays a key role in meeting the public's reasonable expectation of probity and impact by charities.**

Steps	Description
Telling Your Story	<ul style="list-style-type: none"><li>• What is your one overall theme and what are the three key messages you want the reader to take away</li><li>• You also need to think about your audience</li><li>• Not to solely tell your story through hard facts and figures, use even Testimonials and Case studies</li></ul>
Governance	<ul style="list-style-type: none"><li>• There is a need to clearly demonstrate the commitment of the organization to good governance</li><li>• Demonstrate real desire to continuously enhance governance</li><li>• Illustration of compliance levels with sectoral codes and regulations</li></ul>
Financials	<ul style="list-style-type: none"><li>• Provide insight into what is driving the key numbers in the primary statements and it should also place those numbers in the context of the plans, targets and budgets for the year</li><li>• Key performance indicators which you as an organization focus on</li><li>• Restricted and unrestricted funds</li><li>• Deferred income</li></ul>
Accounting Policies	<ul style="list-style-type: none"><li>• The importance and value of accounting policy is significantly underestimated, in my opinion</li><li>• Benchmark policies with the financial policies with similar organizations as a point of reference, but ensure you make them your own</li><li>• Seek to understandability of your financial statements</li></ul>
Outputs, Outcomes and Impact	<ul style="list-style-type: none"><li>• Reporting on outputs, outcomes and impact revolves on the change you as an organization are instituting over time</li><li>• Institute a strategic plan against which to report outcomes</li><li>• Have a means of recording, measuring and monitoring that change over time</li></ul>

# WHY ARE FINANCIAL STATEMENTS REQUIRED?

Depending on the structure of the NPO, its governing legislation may require periodic financial reporting as part of its governance obligations. Funding providers (both private and government) often require financial statements as part of their acquittal process. Members and other stakeholders can also impose financial reporting obligations through an NPO's constitution or other means. Financial statements are also used for internal purposes by the management and staff. However, the needs of internal users and those of external users, are not necessarily the same.

# WHY ARE FINANCIAL STATEMENTS REQUIRED? Cont'd.....

Financial reporting by NPOs provides information to users to demonstrate effective stewardship and accountability, and to assist their decision-making. NPOs are normally accountable to those that provide them with resources, and those that depend on them for the services or goods they provide.

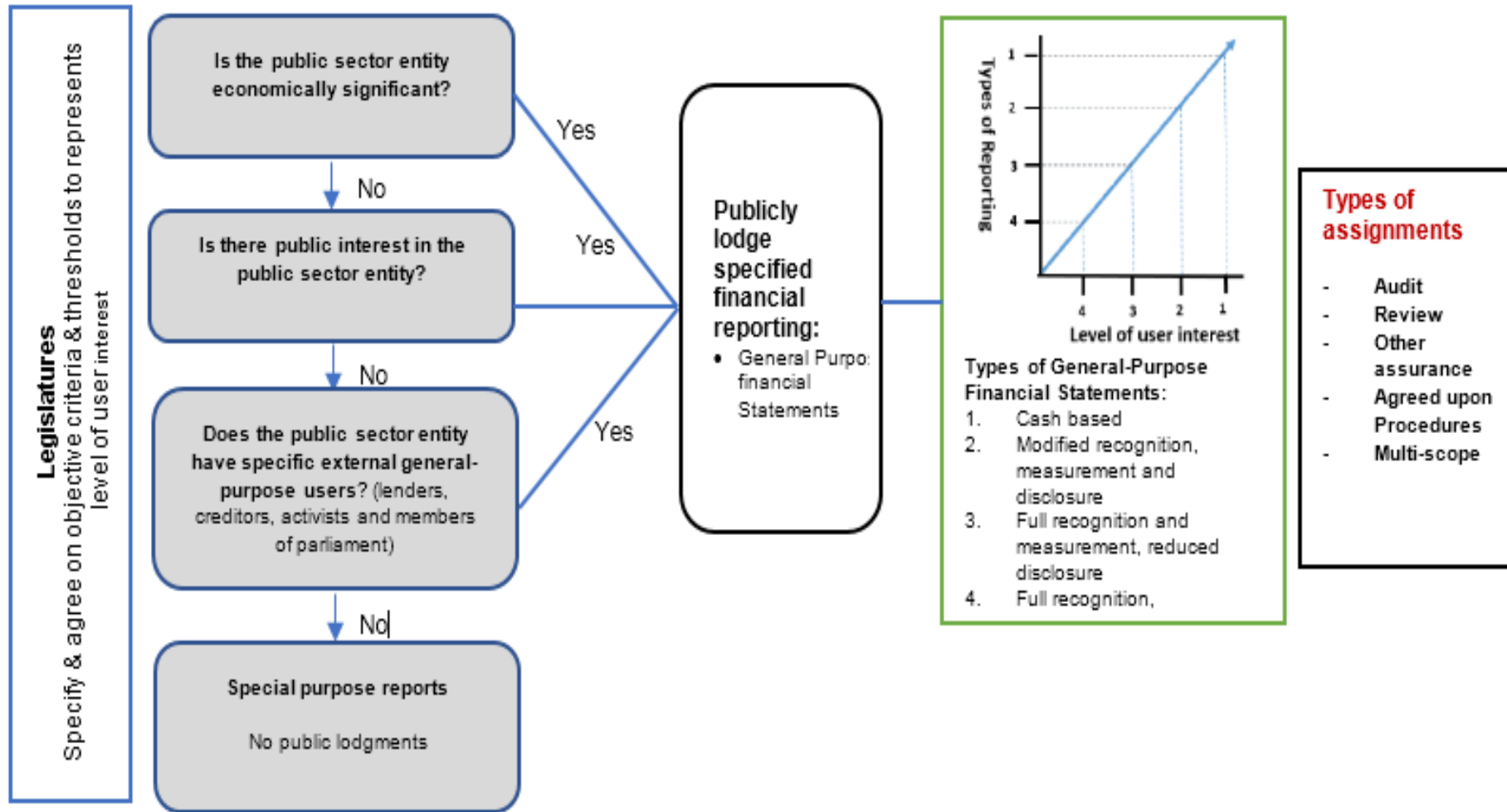
The form and content of financial statements prepared by NFPs can vary significantly depending on their size, type, and statutory or other requirements.

# WHAT ARE FINANCIAL STATEMENTS?

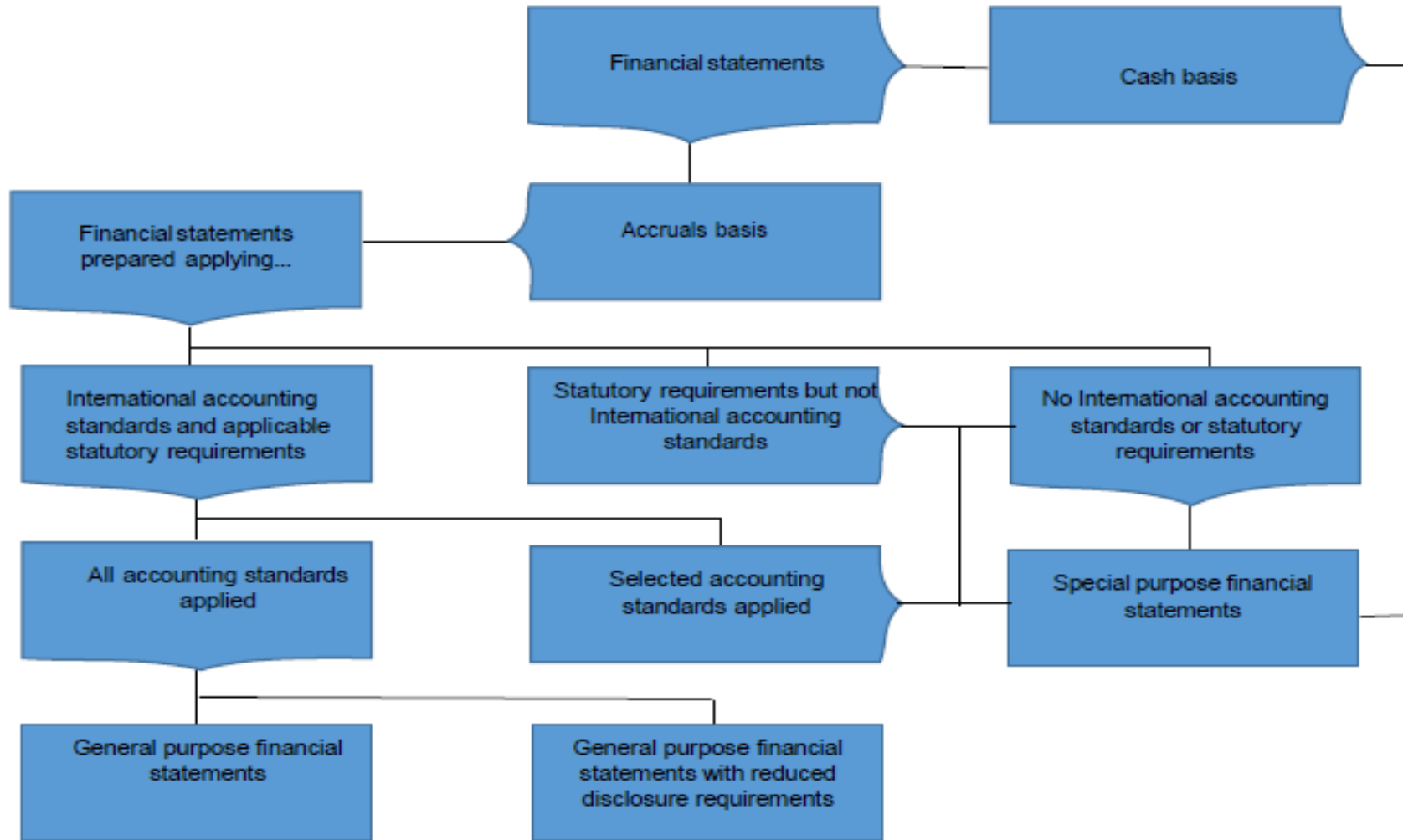
Most people use the terms “financial statements”, “financial report” and “annual report” interchangeably when talking about the annual documents produced by NPOs. However, the reality is that the terms financial statements and financial report have special legal meanings.

The illustration in the next slide identifies some of the common bases and criteria applied in the preparation of NPO financial statements.

# DETERMINING WHO SHOULD PUBLICLY LODGE AND THE LEVEL OF REPORTING



# WHAT ARE FINANCIAL STATEMENTS? Cont'd...



# WHAT ARE FINANCIAL STATEMENTS?

## Cont'd...

As illustrated Previously, financial statements may or may not be prepared in accordance with International accounting standards (hereafter referred to as accounting standards). This will depend on the purpose of the financial statements and other factors including applicable legislation.

# TYPES OF FINANCIAL STATEMENTS

Within the NPO sector, significant differences exist in the form and content of financial statements (or financial reports) prepared by different NPOs.

# An example: HACT Framework

- ▶ What
- ▶ Harmonised Approach to Cash Transfer (HACT)
- ▶ Part of 'Delivering as One' & harmonisation of business practices (UNDG) agenda
- ▶ Launched April 2005: UNDP, UNFPA, WFP & UNICEF
- ▶ From rigid, project-level controls to risk management approach looking at IP;
- ▶ Applied across the whole project lifecycle (NB if project under 1 year, HACT may not be an effective approach)
- ▶ Developed and promoted by the HACT Advisory Committee
- ▶ Why?
- ▶ Simplify and harmonise procedures and processes (for both IP's and Agencies)
- ▶ Avoid duplication. Reduce transaction costs / operational costs
- ▶ Strengthen IP capacities
- ▶ Mitigate risks / improve resource management
- ▶ Promote knowledge-sharing and best practice across the UN system
- ▶ 'Reward' those IP's with stronger financial management capabilities by reducing amount of assurance activities required.

# HACT: PROCEDURES

	TYPE	OBJECTIVE	TIMING
Assessment	Macro-	<ul style="list-style-type: none"> <li>Ensure adequate awareness of the public financial management environment within which agencies provide cash transfers</li> <li>Desk based review of the PFM system (financial environment, national procurement capacity, FX volatility, informal market presence, SAI strength etc.)</li> </ul>	Once per programme cycle
	Micro-	<ul style="list-style-type: none"> <li>Assess the IP's financial mgt. capacity to determine the overall risk rating (low, moderate, significant, high) &amp; related assurance activities.</li> <li>Modality for cash transfers (direct cash transfer, direct payment, reimbursement)</li> </ul>	May not be deemed required (non-assessed) otherwise results valid for period not exceeding the duration of the programme cycle (assuming no significant changes to IP)
Assurance	Financial Audit	Gives an opinion on the veracity of financial reports for a given reporting period. Focus on substantive testing	
	Internal controls audit	Gives an opinion on the control environment in operation over financial management and reporting	
	Spot Checks	Review (no opinion) of expenditure reported in a period and steps taken in relation to remedial actions identified from micro-assessment	

# **TYPES OF FINANCIAL STATEMENTS Cont'd...**

## **FINANCIAL STATEMENTS PREPARED ON A CASH BASIS OF ACCOUNTING VS. AN ACCRUALS BASIS OF ACCOUNTING**

### **Cash basis of accounting**

Under this most simple method of accounting, only the cash receipts and cash payments are recorded and presented in the statement of comprehensive income. Cash balances at the end of the financial year (at the bank and on hand) may also be presented alongside the statement of comprehensive income.

# TYPES OF FINANCIAL STATEMENTS Cont'd...

## Accruals basis of accounting

The accruals basis of accounting is widely accepted as the more appropriate method for preparing financial statements, and the International accounting standards are based on the accruals basis of accounting.

Expenses also include depreciation, which is an annual expense to reflect an entity's use of its assets.

## TYPES OF FINANCIAL STATEMENTS Cont'd...

- ▶ GPFS refers to financial statements that are prepared by applying all relevant accounting standards.
- ▶ GPFS are normally intended for a wide range of users.
- ▶ SPFS are usually intended for a narrow range of users.

# HOW TO READ NFP FINANCIAL STATEMENTS

There are similarities and differences in the information needs of users of NFP financial statements, and the information needs of users of for-profit financial statements.



# HOW TO READ NFP FINANCIAL STATEMENTS Cont'd...

## Common questions asked by users of for-profit financial statements

- ▶ What is the profit (or loss) made by the entity in the financial year?
- ▶ What is the financial strength of the entity?
- ▶ Does the entity generate a satisfactory return on my investment?
- ▶ Does the entity have a viable and sustainable future?
- ▶ Is this an entity I can invest in, or lend money to?
- ▶ How effective is the entity's management?

# Common questions asked by users of NFP financial statements

## Common questions asked by users of NFP financial statements

- ▶ How well has the entity performed in meeting its objectives?
- ▶ What is the financial strength of the entity?
- ▶ Has the entity fulfilled its commitments in exchange for funds received?
- ▶ Does the entity have a viable and sustainable future?
- ▶ Is this an entity (or activity undertaken by the entity) I want to donate to or contribute funds to?
- ▶ How effective is the entity's management?

# Which Standards Apply?

## **1. NPO A acquires an interest in another NGO B**

- a) Does goodwill under IFRS apply? (IFRS 3 Business combination)
- b) How do you treat the results of NGO B?
- c) Can you recognise gain or loss in the statement of income?

## **2. NPO A has a new office in Wajir County comprising community elders**

- a) Are these Wajir offices subsidiaries, joint ventures, associates? (Refer IFRS 10 which requires consolidation)
- b) Understanding the operational accountability?
- c) Can you treat them as branches and therefore include results and assets of office in NPO A?

# Goals and Objectives of the IASB and IPSASB

The goals of the IASB and IPSASB are similar. The IASB seeks to “to develop a single set of high quality, understandable, enforceable and globally accepted IFRSs” (IFRS Foundation, 2013).

The IPSASB ’ s objective is to “ enhance the quality and transparency of public sector financial reporting by establishing high-quality accounting standards ... [and] promote the adoption and international convergence to IPSASs” (IPSASB, 2013a).

Both the IASB and IFAC state that their work of developing and pronouncing internationally converged financial reporting standards is in the public interest.

# Which Standards Apply? Cont'd...

**3. NPO A has a contract with Bill and Melinda Gates to receive \$1 million as donor contribution, (delayed pending audit)**

- a) Does this qualify as an asset?
- b) IFRS 9 on financial instruments on classifying and measuring financial assets and how do you measure the fair value of the \$1 million delayed?
- c) IPSAS 23 on Revenue section 93 on gifts, donation including goods in kind
- d) Can you therefore exclude the \$1 million from the assets?

**4. NPO A has a boarding facility that it houses underprivileged kids**

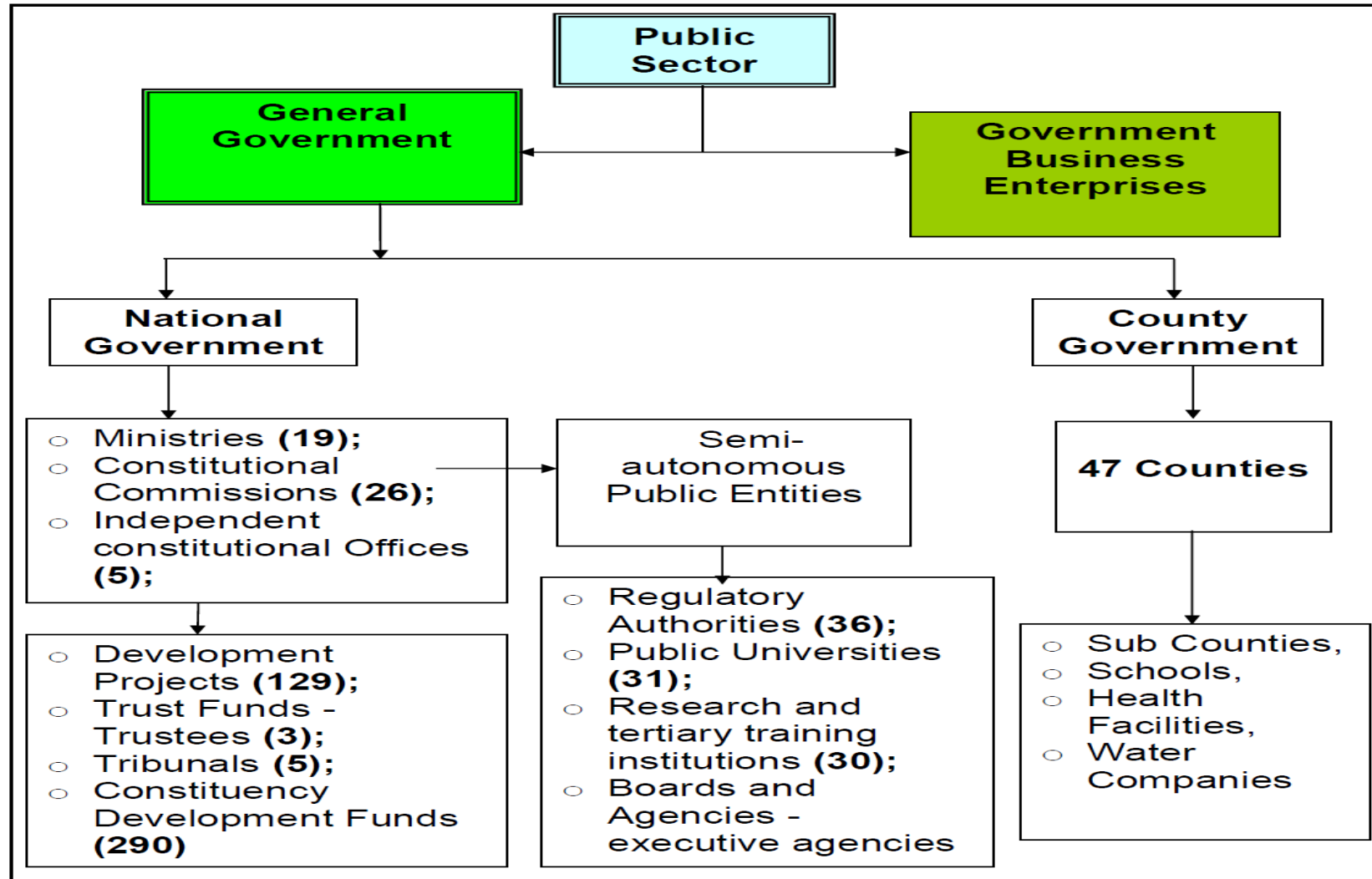
- a) Does this qualify as property, plant & equipment? (IAS 16) (where are the future economic benefits)
- b) What value and depreciation applies on it if any?
- c) Can we book the asset at cost as a social asset for operational purposes?

# PSASB's strategic direction & IPSAS roadmap



- ▶ The PSASB ADOPTED the financial reporting standards applicable to public sector entities as follows:
  - National & County Governments –IPSAS Cash basis of accounting; accounting;
  - Semi Autonomous Government Agencies (SAGAs) –IPSAS accrual; and
  - State Corporations (Commercial) –IFRS.
- ▶ The Standards became effective on 1st July 2014 and were communicated to the entities via Treasury Circular dated 1st July 2014 and subsequently gazette notice 5440 on 1st August 2014

# PUBLIC SECTOR AT A GLANCE



# Corruption



- ▶ Very complex phenomena, not easy to define.
- ▶ Systematic and spontaneous.
- ▶ If you are asking yourself 'is it a corrupt activity' it probably is.
- ▶ Effects of corruption on GDP, if level of corruption increases by 1% it leads to a drop in GDP of 3%. Big impact on foreign direct investment.
- ▶ Real damage to society occurs when entire generation of youth are mis-educated by example to believe that personal success comes not through merit but corruption.
- ▶ 2017 survey with youth;
  - They would do it if they knew they would not get caught.
  - The question is 'how much is the value.'

# Corruption Cont'd...

## Accounting and corruption

Accounting serves a dual role;

- Accounting
- Auditing

Studies show that financial reports with high transparency show lower level of corruption.

Example of New Zealand economic reform:

- Separate private sector operation from government
- Strengthen accountability and transparency
- Management performance tools to appraise public sector
- Move to performance based budgeting system
- Shift to accrual accounting
- Strengthen audit systems



# Corruption Cont'd...

## CHAPTER TWELVE – PUBLIC FINANCE

### PART I – PRINCIPLES AND FRAMEWORK OF PUBLIC FINANCE

#### 201 Principles of public finance

The following principles shall guide all aspects of public finance in the Republic;

- (a) There shall be openness and accountability, including public participation in financial matters,
- (b) The public finance system shall promote an equitable society,
- (c) The burdens and benefits of the use of resources and public borrowing shall be shared equitably between present and future generations,
- (d) Public money shall be used in a prudent and responsible way; and
- (e) Financial management shall be responsible, and fiscal reporting shall be clear.

# Corruption Cont'd...

## Examples in Kenya

OAG Reports: - Publicly available on the net

County assembly downloads

- I. Key information
  - II. Key Management
  - III. Budget Performance
  - IV. Projects
  - v. Compliance with cash basis of IPSAS
  - vi. Audit Report (Refer attachment)
    1. Bungoma Financial Statement
    2. Harrow UK Financial Statement
- (ON: How useful are the financial reports)



Bungoma CA



Harrow UK FS

# Corruption Cont'd ...

## Corruption in Kenya

1. YouTube search – (See snapshot next slide)

2. Finance Act 2018 – Accountants Act 2008

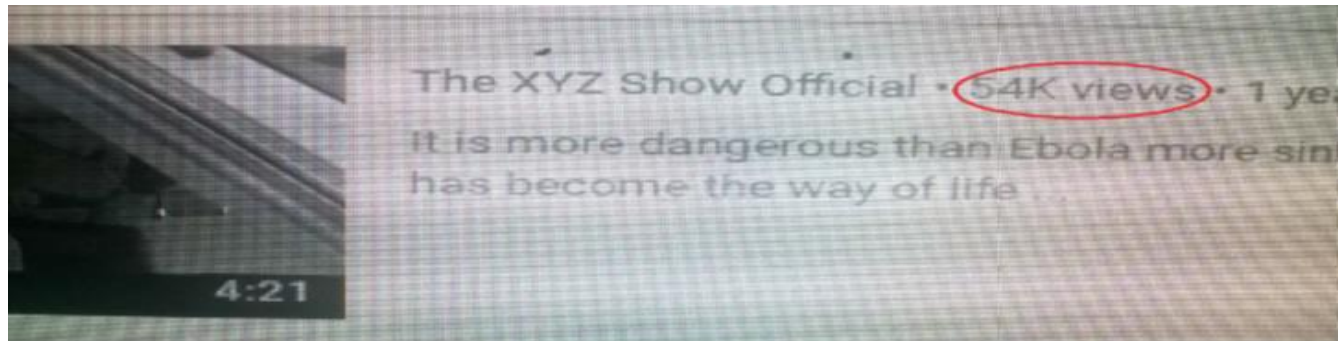
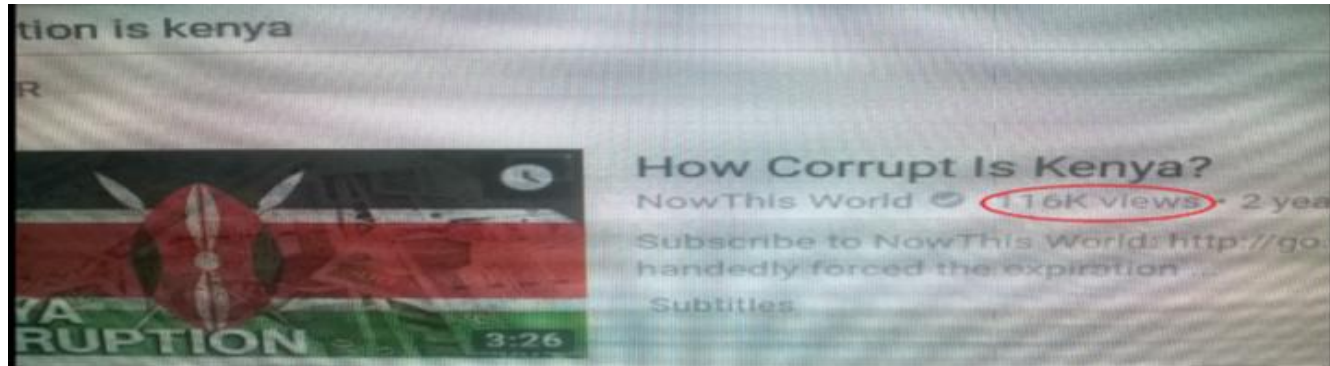
Emphasis of ethical guidelines – shall take precedence over any other instructions.

Are accountants being fairly treated?

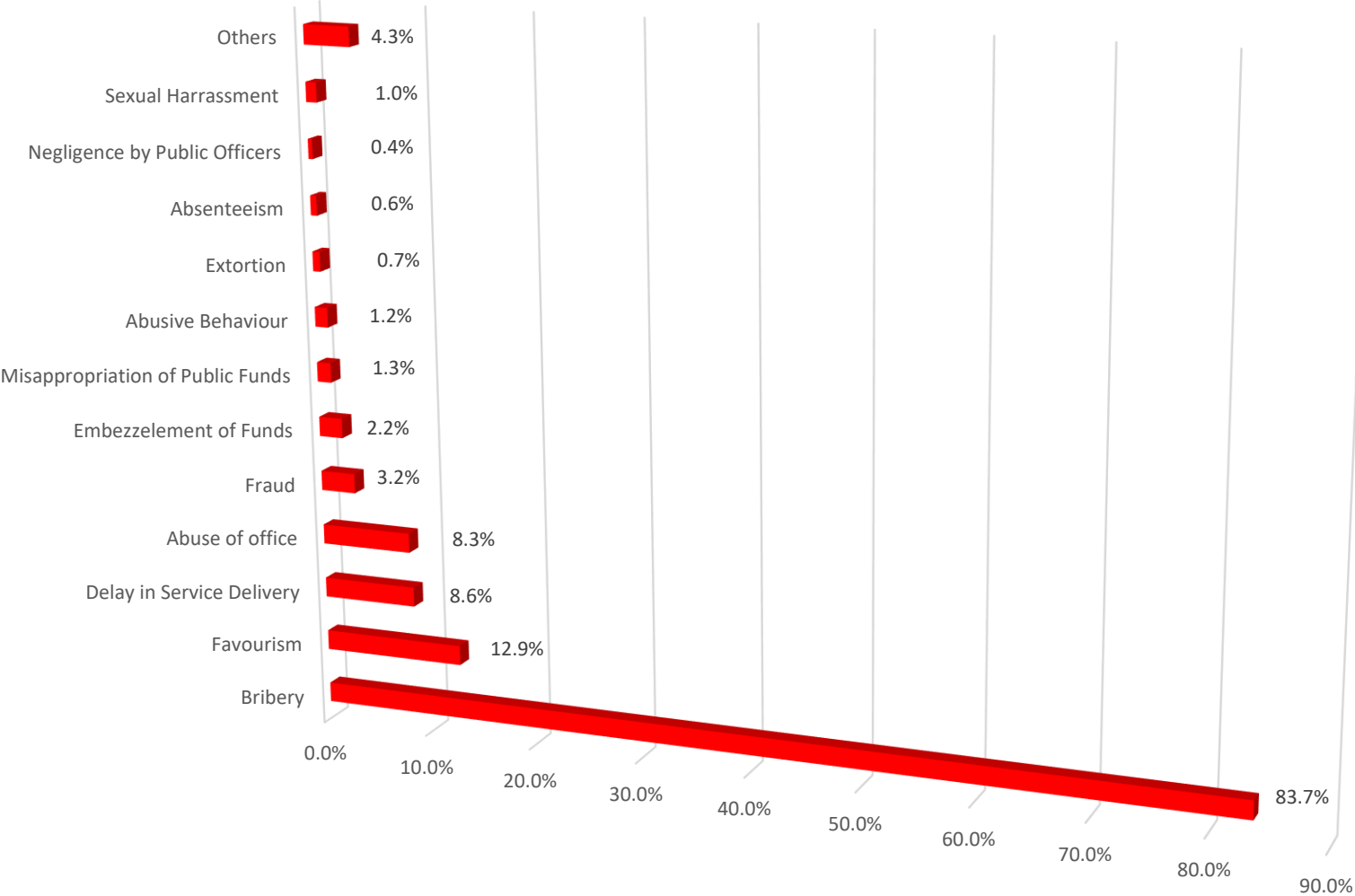
3. Finance Act 2018 – S 65 Banking regulations proposal to lift regulations proposal to lift regulations on manner and form of;

- banking deposits and withdrawals power with parliament.
- Cash deposits.
- Tax amnesty.
- Ministry of Devolution and planning
  - ✓ NIMES Dashboard
  - ✓ Moving to M&E System – GOK Dashboard

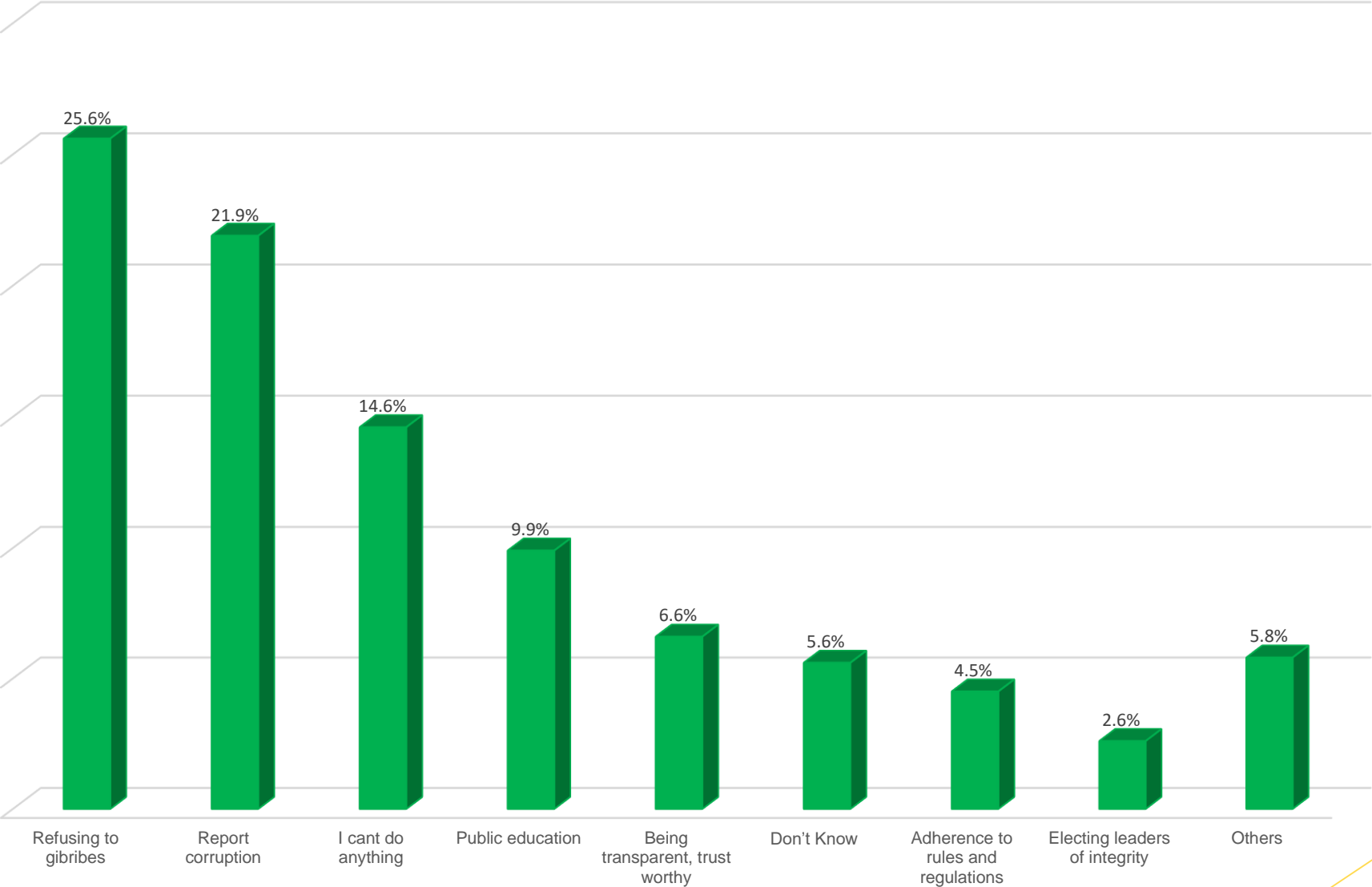
# SNAPSHOTS OF YOUTUBE VIEWS



# Forms of Corruption and unethical Behaviour Observed



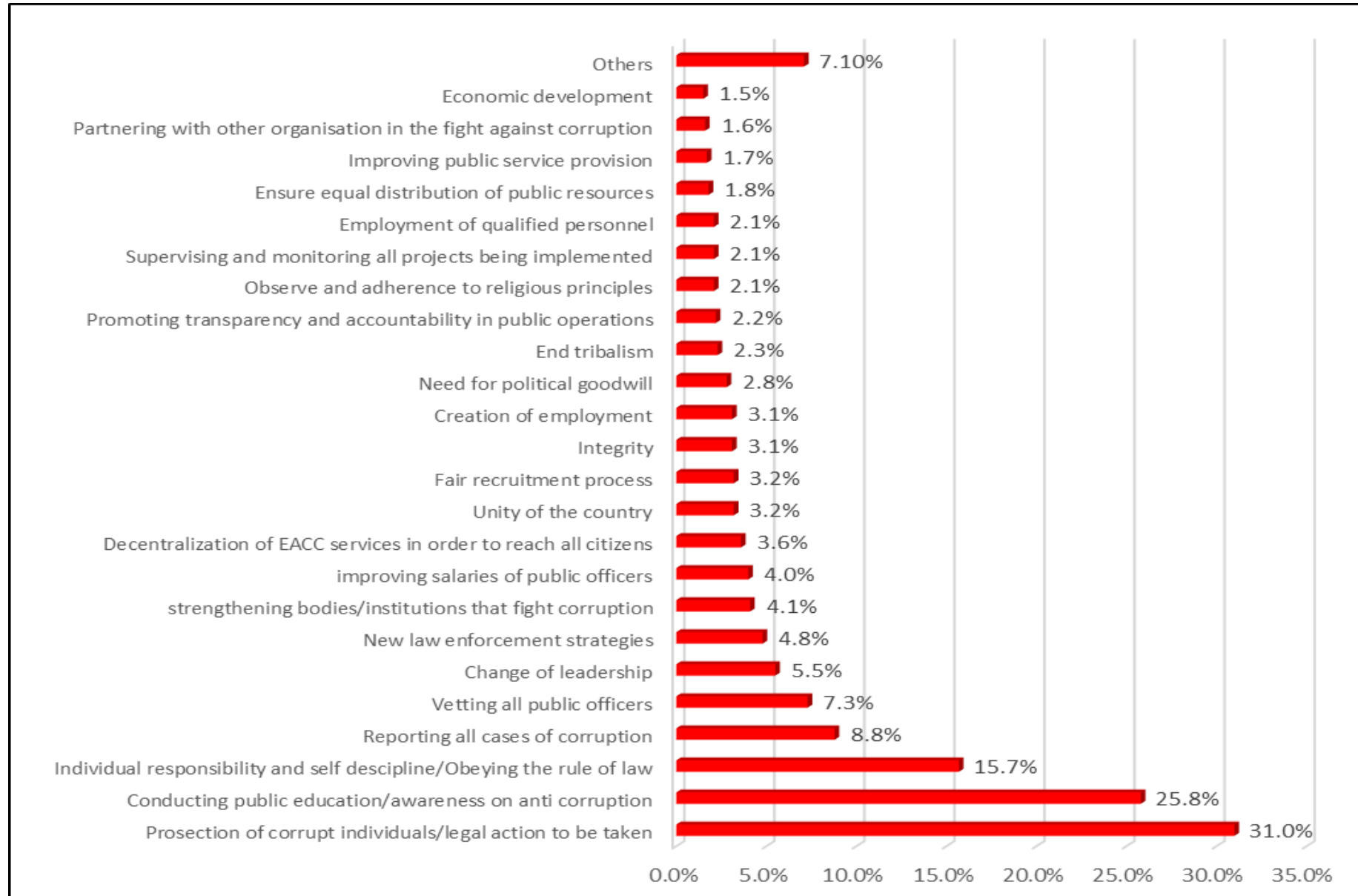
# Individual role in the fight against corruption



# 2020 Corruption Risk Matrix

Likelihood	5	5	10	15	20	25
	4	4	8	12	16	20
	3	3	6	9	12	15
	2	2	4	6	8	10
	1	1	2	3	4	5
		1	2	3	4	5
		Impact				

# Suggestion on how to reduce corruption in the country



# STATEMENT OF FINANCIAL REPORTING GUIDELINES (SOFREP) KENYA

- ▶ The PBO Benefit Authority recognizes the need for locally registered PBO's, currently referred as Non-Governmental Organizations (NGOs) to carry out proper financial recording.
- ▶ PBO's continue to have different financial reporting format to suit their needs.
- ▶ In compliance with these requirements, the NGO Board has come up with a reporting format that harmonizes the requirements of financial reporting as laid out in the various professional documents and the requirements of the local statutes.
- ▶ The statement of financial reporting guidelines should be used together with the standards (IFRS & IPSAS) and are not meant to replace the standards.
- ▶ This Statement is intended to apply to all PBOs operating in the country, regardless of their size, constitution or complexity. **It provides the basis for the preparation of accrual accounts to give a true and fair view.**

# SOFREP Cont'd...

- ▶ Where necessary, these guidelines should be adapted to meet
  - a) Any statutory requirements relating to the form and content of accounts; and
  - b) To the extent that the following exceed statutory requirements:
    - Any requirements imposed by the PBO own governing documents (e.g. By-laws or similar); and/or;
    - Any requirements imposed by agreements or contracts that may have been entered into, (e.g. donor agreements/contracts). E.g European Commission grants.
- ▶ The objectives of the SOFREP are intended to achieve the following:
  - Enhance accountability amongst the organizations registered under the Act,
  - Obtain uniformity in the financial reporting
  - Enhance comparability of the various financial reporting frameworks

# SOFREP Cont'd...

The PBO directors will ensure that financial statements include the following:

- a) Statement of Fund Activities
- b) Income and Expenditure Statement
- c) Statement of Financial Position
- d) Statement of Cash Flow
- e) Notes to the Financial Statements

## Annual Reports

The financial statements when presented alone do not convey in-depth information about the organization's activities. It's the responsibility of the Board of directors to disclose additional information on the PBO activities.

# SOFREP Cont'd...

## Achievements and Performance

The report must contain summary of the main achievements during the period within the society/ community that it has been undertaking its activities. The details of the report should where applicable provide indicators realized.

Every PBO should have a clear plan on fundraising and the use of those funds.

# SOFREP KEY POINTS:

- ▶ All PBOs must prepare a set of accounts at least annually and they should normally have a 12-month reporting period.
- ▶ All PBOs should prepare their accounts in the Kenyan currency.
- ▶ PBOs, in preparing their accounts, should give particular consideration to material items or transactions as their omission or misstatement could influence economic decision-making by the user of the accounts and any assessment of the stewardship of charitable funds.
- ▶ PBO must not offset assets and liabilities, or income and expenses, unless required or permitted by this SOFREP or the relevant accounting standard.
- ▶ The standards also require donated services and facilities to be measured at the value of the gift to the PBO.

# STATEMENT OF FINANCIAL ACTIVITIES

	Unrestricted funds	Temporary Restriction	Permanent Restriction	Total funds	Prior period total funds
	Kes	Kes	Kes	Kes	Kes
<b>Income and endowments:</b>					
Donations/Grants					
Earned from PBO activities					
Earned from other activities					
Investment and other income					
Total					
<b>Expenditure:</b>					
Direct Cost of raising funds					
Other direct expenses					
Expenditure on charitable activities					
Other expenditure					
Total					
<b>Net incoming resources (resources expended) before investment gains/(losses)</b>					
Net gains/(losses) on investments					
<b>Net incoming resources (resources expended)</b>					
<b>Transfers between funds</b>					
<b>Other recognized gains/(losses):</b>					
Gains/(losses) on revaluation of fixed assets					
Actuarial gains/(losses) on defined benefit pension schemes					
Gains /losses on foreign exchange					
Other gains/(losses)					
<b>Net movement in funds</b>					
<b>Reconciliation of funds:</b>					
Total funds brought forward					
<b>Total funds carried forward</b>					

# STATEMENT OF FINANCIAL POSITION

## STATEMENT OF FINANCIAL POSITION

Ref.		Total funds	Prior Year	Notes
		Kes	Kes	
	<b>Non-Current/Fixed assets:</b>			A
	Intangible assets			A <sub>1</sub>
	Tangible assets			A <sub>2</sub>
	Heritage assets			A <sub>3</sub>
	Investments			A <sub>4</sub>
	Operating Lease			A <sub>5</sub>
	<b>Total Non-current/Fixed assets</b>			
	Biological assets			A <sub>6</sub>
	<b>Current Assets:</b>			B
	Inventories (Stock)			B <sub>1</sub>
	Debtors/Receivables/Prepayments			B <sub>2</sub>
	Investments			B <sub>3</sub>
	Cash at bank and in hand			B <sub>4</sub>
	<b>Total Current Assets</b>			
	<b>Liabilities:</b>			C
	Creditors			C <sub>1</sub>
	Net current assets or liabilities			
	Total assets less current liabilities			
	Provisions for liabilities and charges.			C <sub>2</sub>
	Net asset or liabilities excluding pension asset or liability			
	Defined benefit pension scheme asset or liability			C <sub>3</sub>
	<b>Total Net Assets or Liabilities</b>			
Ref.		Total funds	Prior Year	Notes
		Kes	Kes	
	<b>The Funds of the PBO:</b>			D
	Endowment funds			D <sub>1</sub>
	Restricted income funds			D <sub>2</sub>
	Unrestricted funds			D <sub>3</sub>
	Revaluation reserve			D <sub>4</sub>
	<b>Total PBO Funds</b>			

# Statement of Cash Flows

Statement of Cash Flows

	Total Funds	Prior Year	Notes
	Kes	Kes	
<b>Cash flows from operating activities:</b>			
<b>Receipts</b>			
Donations	X	X	
Grants	X	X	
Interest received	X	X	
Other receipts	X	X	
Income from services rendered	X	X	
<b>Payments</b>			
Employee costs	X	X	
Interest paid	X	X	
Supplies	X	X	
Other payments	X	X	
<b>Net cash provided from (used in) operating activities</b>	X	X	
<b>Cash flows from investing activities:</b>			
Dividends, interest and rents from investments	X	X	
Proceeds from the sale of property, plant and equipment	X	X	
Purchase of property, plant and equipment	(X)	(X)	
Proceeds from sale of investments	X	-	
Purchase of investments	-	(X)	
<b>Net cash provided by (used in) investing activities</b>	X	X	
<b>Cash flows from financing activities:</b>			
Repayments of borrowing	(X)	(X)	
Cash inflows from new borrowing	X	-	
Receipt of endowment	X	X	
<b>Net cash provided by (used in) financing activities</b>	X	X	
Change in cash and cash equivalents in the reporting period	X	X	
Cash and cash equivalents at the beginning of the reporting period	X	X	Table 8.2
Change in cash and cash equivalents due to exchange rate movements	X	(X)	
<b>Cash and cash equivalents at the end of the reporting period</b>	X	X	Table 8.2

# STATEMENT OF FINANCIAL ACTIVITIES Cont'd...

## Recognition of Income

Income should as far as practicable be reported gross, and the aggregate total should be separately identified.

Incoming resources-Should be recognized in the Statement of Financial Activities when the effect of a transaction or other event results in an increase in the PBO's assets. This will be dependent on the following three factors being met.

- ▶ **Entitlement** – Normally arises when there is control over the rights or other access to the resources, enabling the PBO to determine its future application.
- ▶ **Certainty**-When its virtually certain that the incoming resources will be achieved
- ▶ **Measurement** – When the monetary value of incoming resource can be measured with sufficient reliability.



# STATEMENT OF FINANCIAL ACTIVITIES Cont'd...

Grants should not be recognised until the conditions for receipt have been complied with.

Grants restricted to future accounting periods should be deferred and recognised in those future

## Donated Services

PBO may receive assistance in the form of donated facilities, beneficial loan arrangements or donated services. Such services will be included in the statement of financial activities where the benefit to the organization is reasonable, quantifiable and measurable. The value should be based on estimated value of the service.

Some PBOs receive substantial amounts of voluntary help. Such help should not be accounted for in the Statement of Financial Activities, but should be dealt with in the notes to the accounts or in the Directors' Annual Report.



# STATEMENT OF FINANCIAL ACTIVITIES Cont'd...

## Recognition of Expenditure

Any expenditure incurred and not paid in line with the accrual basis will be recognized as a liability in line with applicable standards.

Where a PBO enters into any material transaction, contract or other arrangement (including a grant) with any connected person, the amounts involved and the terms and conditions should be disclosed in the notes to the accounts.

## Emoluments of Employees

The total emoluments (i.e. remuneration and benefits-in-kind, as defined for taxation purposes) for the year of the PBO's employees and the average number of employees for the year should be disclosed in the notes to the accounts.



# STATEMENT OF FINANCIAL ACTIVITIES Cont'd...

## Cost of Audit, Independent Examination and other Financial Services

The notes to the accounts should disclose separately the amount payable in respect of:

- a) Audit or independent examination services and
- b) Other financial services such as taxation advice, consultancy, financial advice and accountancy, disclosing the fees separately under each head.



# STATEMENT OF FINANCIAL ACTIVITIES Cont'd...

## Property Plant & Equipment



### Property, Plant & Equipment

Property, Plant & Equipment assets are recognized when:

- a) A resource is controlled by the PBO as a result of a past event or transaction, for example a past gift or purchase;
- b) It is probable that the expected future economic benefits associated with the asset will flow to the PBO; and
- c) The historical cost or fair value of the asset can be measured reliably.

### Heritage Assets

The cost of the heritage will only be brought in the financial statements if it's known.

# STATEMENT OF FINANCIAL ACTIVITIES Cont'd...



## Accounting for **DEPRECIATION**

The PBO should choose a depreciation method which reflects the use of the asset and the expected timing or pattern of consumption of its economic benefits.

PBOs that constantly replace their tangible fixed assets as they wear out may opt not to depreciate them provided their value is not material and their quantity, value and composition are not subject to material variation from one year to the next.

THANK  
YOU

Q & A

