



# NPO Accounting Basis Tool – Strategic Choices and donor negotiation

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# Accounting Basis: Diagnostic and Strategy Tool for NPOs and funders

Cash, modified cash and accrual basis

# Introduction

1. About the tool
2. Accounting in NPOs
3. Cash , accrual and modified cash
4. Accounting basis used in different reports
5. Impact of accounting basis decisions
6. How to use the tool



Please read this slide deck in 'slide show mode, using the mouse or arrows to click

# About Humentum

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# Section 1

About the tool

# 1.1 Who is this tool designed for?

- The tool is designed for:
  - ✓ non-profit organisations
  - ✓ funders that request financial reports from NPOs
- This slide deck explains the background to the tool and how to use it.
  - A link to the tool itself is in the final slide

# 1.2 What can the tool do for NPOs?

- NPOs (as grantees) may use the tool to:

✓ Clearly **describe** the basis currently used its own current accounting and reporting practice

✓ Explore **why** - the result of compliance requirements, capacity constraints, strategic choices or history?

✓ Make **strategic choices** about the accounting and reporting practices it would like to use

✓ **Negotiate with donors** where strategic choices or legal requirements differ from donor requirements.

# 1.3 What can the tool do for funders?

- Funders may use the tool to:

✓ Clearly describe the accounting basis currently allowed or required for its grantee reporting practice

✓ Understand whether current practice is the result of compliance requirements, strategic choices or history

✓ Make strategic choices about the accounting and reporting practices it would like to require or allow

✓ Negotiate with grantees where their strategic choices or legal requirements differ from funder reporting requirements.



# 1.4 What can the tool NOT do?

- The tool does not
  - ✓ Prescribe what is the best or right accounting basis for any given type of transaction, organisation, financial report or funder requirement.
  - ✓ Consider every possible type of transaction. It includes those transactions deemed most common in the NPO sector globally, both exchange and non-exchange.
  - ✓ Define a standard for accrual-based accounting for NPOs. There is currently no internationally applicable standard, which is why Guidance is being developed by the [IFR4NPO](#) project.

# Section 2

## Accounting in NPOs

## 2.1 Simple or complex?

- Accounting and financial reporting should always be
  - As simple as possible to meet the needs
  - Appropriate to the context of the organisation
- There are cost / benefit trade-offs to increasing complexity or sophistication.

## 2.2 Goals of accounting in NPOs



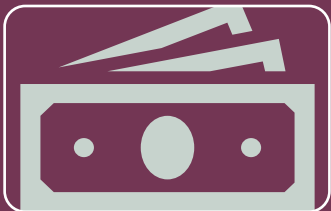
### Useful information

- Internal and external users
- Decision making and accountability



### Control

- Use accounting practice
- Part of effective internal control



### Maximise income

- Recover all project costs (including indirect) from project funders

The selection of accounting treatments in the tool reflect all of the above goals.

# Section 3

Cash, accrual and  
modified basis  
accounting

## 3.1 Accounting basis

- A financial transaction may be recorded on either :

A cash  
basis

or

An accrual  
basis

## 3.2 Cash accounting

- **‘Cash accounting’** records transactions at the point when money is received and paid by an entity
- Maintaining cashbooks for different bank or mobile money accounts, cashboxes and staff working advances is an essential foundation of all accounting.
- Pure cash accounting does not keep track of debtors or creditors, prepayments, accruals, assets, depreciation or commitments.

In a nutshell:

- Essential foundation
- Simpler to do
- Less information

## 3.3 Accrual accounting

- **‘Accrual accounting’** recognises income and expenditure at the point when it is earned or accrued, as distinct from when it is received or paid.
- Accrual accounting includes the capitalisation of fixed assets, and recognition of stocks, debtors and creditors and other liabilities.
- Income may be recognised on the basis of entitlement, whether or not it is actually in the bank.

In a nutshell:

- More complex
- Richer information



## 3.4 Accounting Basis – a binary choice?

- Cash basis or accrual basis?
  - At transaction level, this is true – any given transaction may be captured on a cash only basis, or on an accrual basis
  - (There may be more than one way to report a transaction on an accrual basis, which is why accounting standards are necessary)
- But what if some transactions are recorded on a cash basis and some are on an accrual basis?

# 3.5 Modified basis

## Transaction basis

All on a cash basis

Some on cash basis,  
others on accrual basis

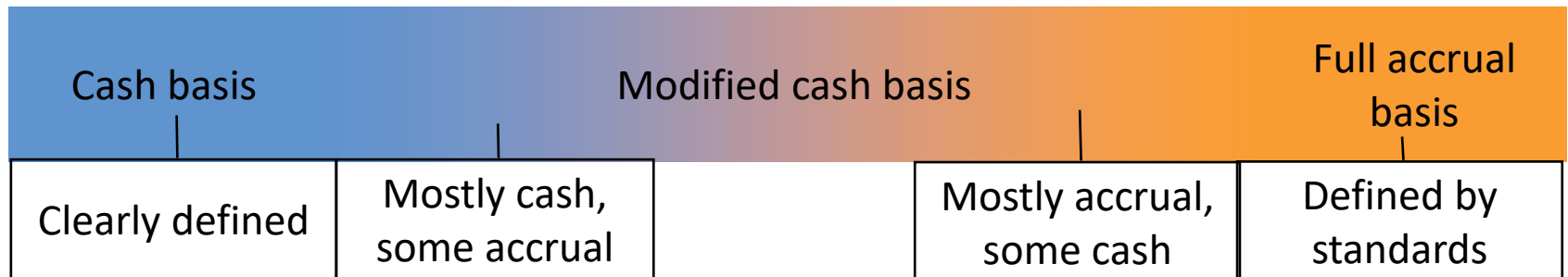
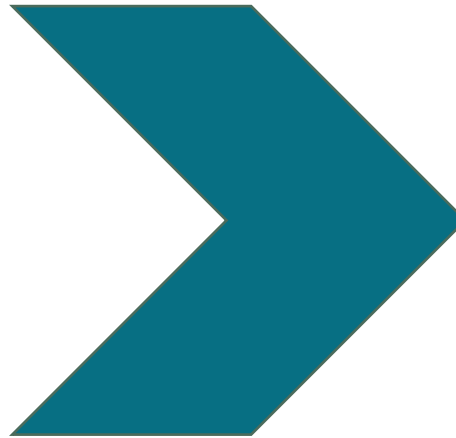
All on an accrual basis (as  
required by a standard)

## Financial reports

Cash basis reports  
(eg receipts and payments  
report)

Modified cash (or hybrid)  
basis reports

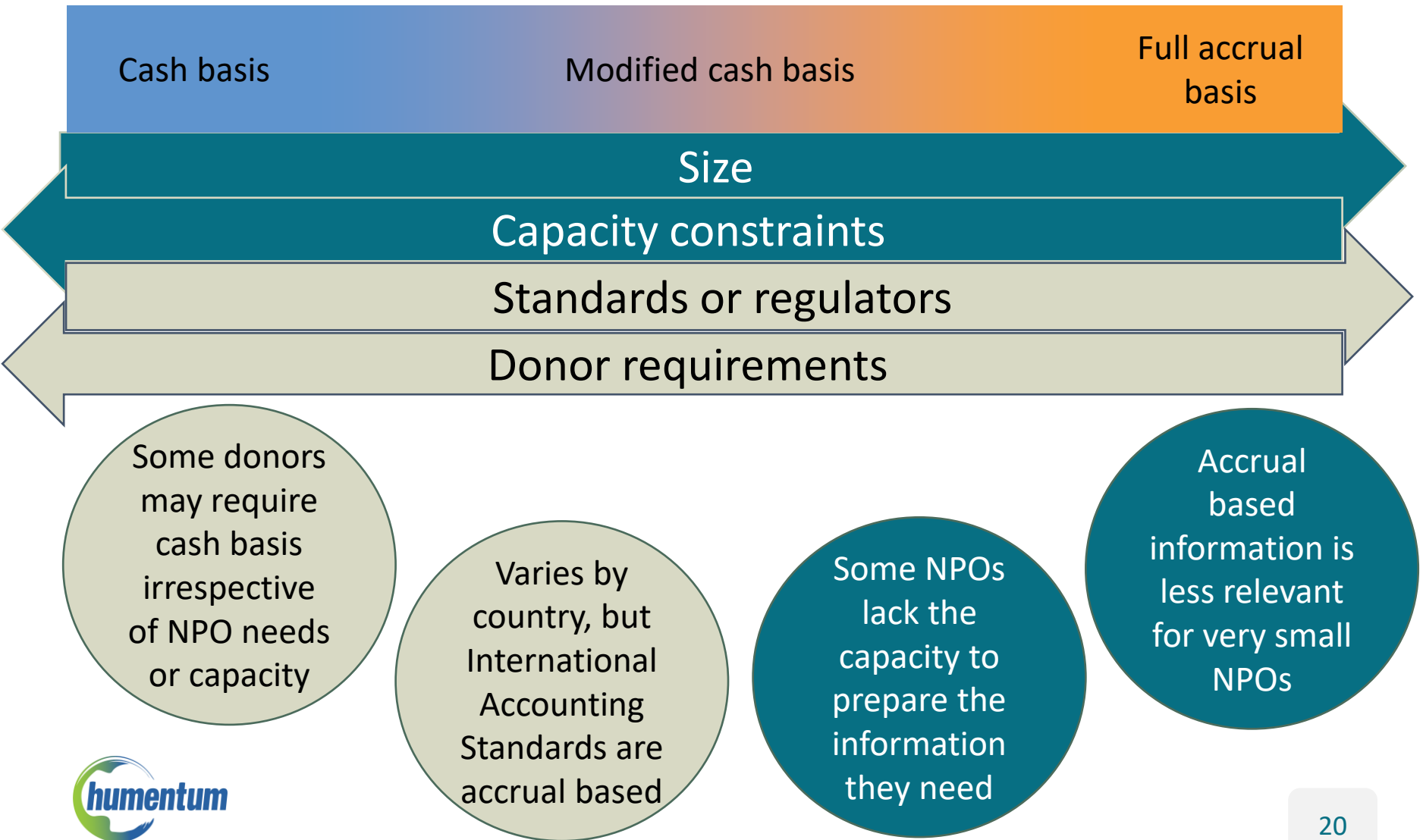
Accrual basis reports  
(eg income statement,  
balance sheet)



## 3.6 Where on the spectrum?

- What is the most appropriate place on the spectrum for a particular NPO? Consider these factors:
  - **Operations** – Does the NPO have assets or liabilities that need to be tracked?
  - **Transactions** – Does the NPO have transactions where there is a timing difference between the value received or given and the movement of money?
  - **Funding sources** – does the NPO have multiple funding sources or different currency bank accounts? Non-cash entries such as revaluations and cost allocations may become necessary
  - **Strategy** – does the NPO wish to grow or improve the rate at which it recovers indirect project costs from funders?
- Size is a relatively easy ‘proxy’ or estimate of an NPO’s need to consider accrual-based information.

# 3.7 Internal and external influences



# Section 4

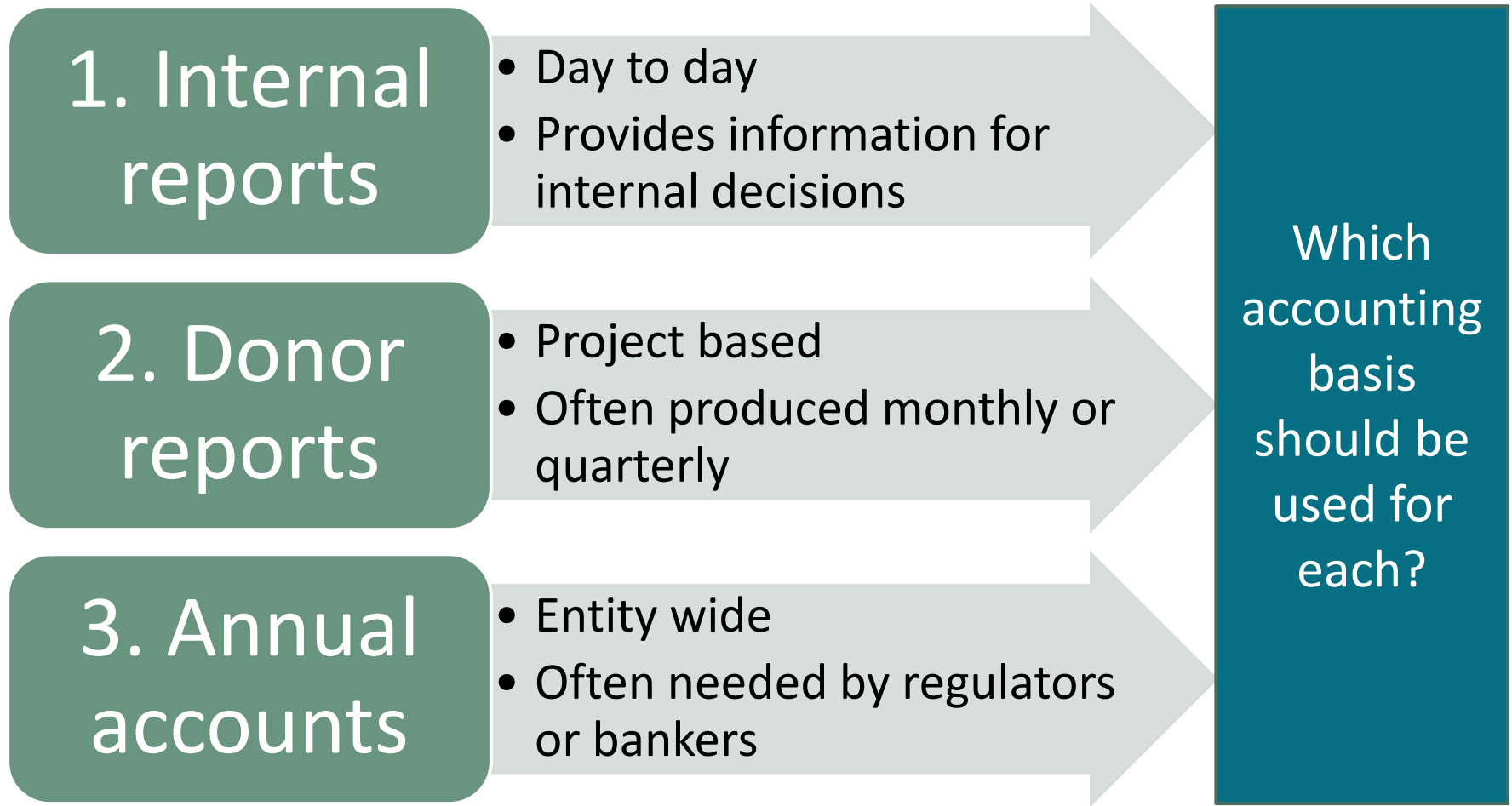
Different reports where  
accounting basis is  
relevant

# 4.1 Outputs from the accounting system

- An NPO accounting system needs to be set up so that it can provide information for:
  - **internal** users such as project managers, budget holders, management and board; and
  - **funders or donors** of particular projects, as needed
  - Other **external users** such as banks, regulators, service recipients, partners, and the public.



## 4.2 Options for NPOs

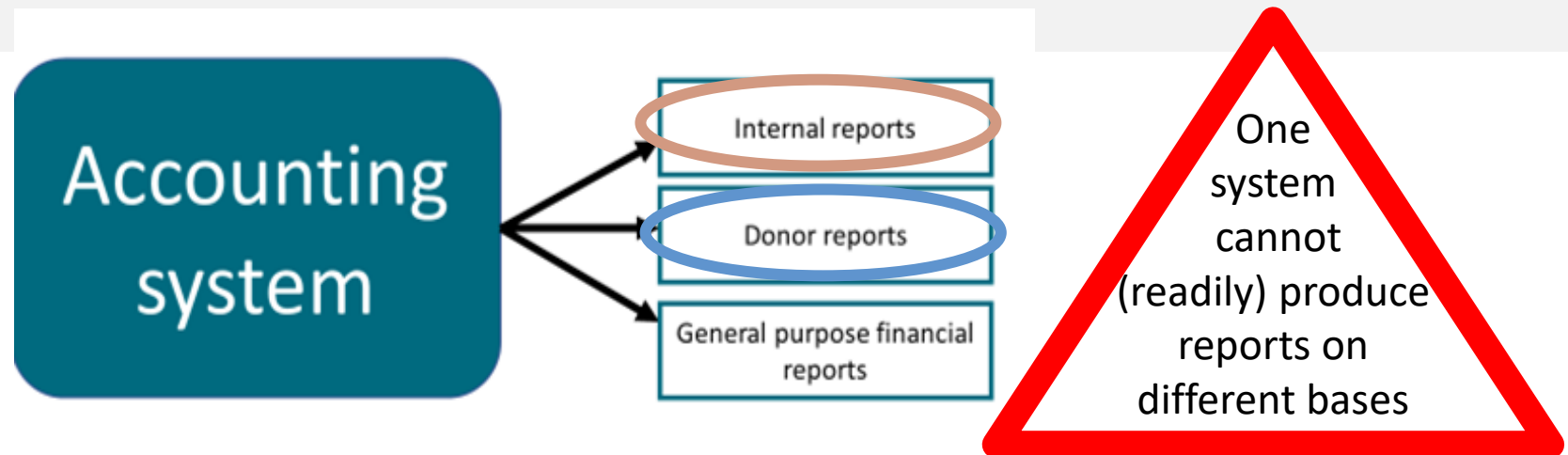


# Section 5

Impact of accounting  
basis conflicts

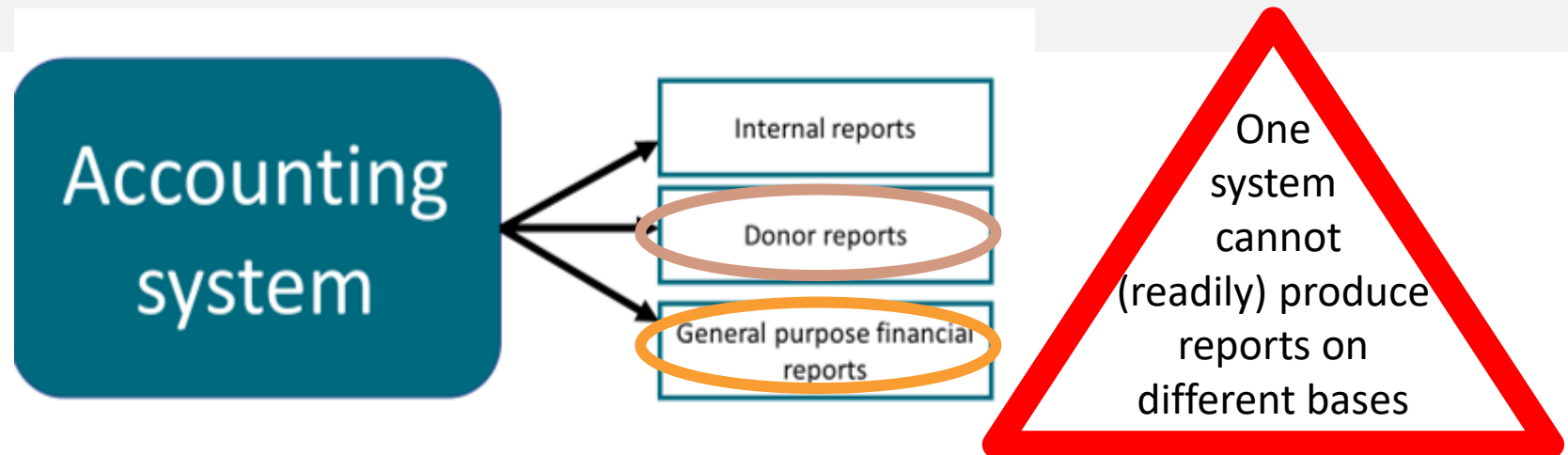


# 5.1 Accounting basis conflicts (1)



- What if an NPO would like to track payroll assets and liabilities (**modified basis**) for its own internal reports, but its donors require project reports on a **cash basis**?

## 5.2 Accounting basis conflicts (2)



- What if an NPO's donor reports are required to be prepared on a particular **modified basis** (eg with equipment expensed) but the annual accounts are required to be on a **full accrual basis** (with asset capitalisation and depreciation)?

## 5.3 Impact of conflicts

- Decisions about accounting basis for different types of reports can impact the following areas:
  - **Fraud:** can donor reports be reconciled to the year-end audited accounts, which is important for fighting double-funding fraud?
  - **Reporting efficiency:** can one system produce all reports, with a minimum of post-ledger (outside the system) manipulation and adjustments in spreadsheets? Are 'budgets' and 'actuals' on the same accounting basis?
  - **Governance:** is information about financial health available to board members and senior management throughout the year? Are the year-end accounts in a familiar format?
  - **External users:** are the needs of external users met?

## 5.4 Scenarios

- The following scenarios assume a generalised Non-Profit Organisation that:
  - is of a size and complexity where at least some accrual-based information would be important
  - has the staff, systems and governance capacity to produce and use at least some accrual-based information
  - has some donor project funding and is required to submit periodic reports
- Each scenario considers the impact of accounting basis decisions on the factors on the previous slide, scoring from 4 (best) to 0 (worst)
- The purpose is to consider some examples where there are trade-offs of different options. Each organisation should consider the scores and trade offs in their own context.

# 5.5 Scenario 1

Report and frequency	Basis
Internal reports (monthly)	Cash basis
Donor reports (quarterly)	Cash basis
Audited accounts (annually)	Cash basis

## Governance

- Consistency between quarterly and year-end reports is helpful, but limited without information about assets or liabilities.

## External users

- The IFR4NPO Project Consultation Paper Chapter 3 makes the case why accrual based information is appropriate for external users.

## Fraud (double funding)

- Donor and year-end reports on the same basis should be reconcilable

## Efficiency

- All three types of report are on the same basis, easy to monitor budgets

Area	Score	8
Fighting fraud	3	
Reporting efficiency	4	
Governance	1	
External users	0	

## 5.5 Scenario 2

Report and frequency	Basis
Internal reports (monthly)	Cash basis
Donor reports (quarterly)	Cash basis
Audited accounts (annually)	Accrual basis

### Governance

- Year-end accounts are on a different basis from during the year. Quarterly reports lack information about assets and liabilities.

### External users

- Accrual-based information most useful for a range of users.

### Fraud (double funding)

- Donor reports not reconcilable to year-end accounts

### Efficiency

- Monthly and quarterly reports are on the same basis, but considerable effort needed for year end accounts.

Area	Score	7
Fighting fraud	0	
Reporting efficiency	2	
Governance	1	
External users	4	

# 5.5 Scenario 3

Report and frequency	Basis
Internal reports (monthly)	Modified basis
Donor reports (quarterly)	Modified basis
Audited accounts (annually)	Accrual basis

## Governance

- Board reports include some information about assets and liabilities. Year end accounts more closely resemble accounts during the year.

## External users

- Accrual-based information most useful for a range of users.

## Fraud (double funding)

- Donor reports not readily reconcilable to year-end accounts

## Efficiency

- Monthly and quarterly reports are on the modified basis (although not necessarily aligned), with relatively little effort needed for year end accounts

Area	Score	11
Fighting fraud	1	
Reporting efficiency	3	
Governance	3	
External users	4	

# 5.5 Scenario 4

Report and frequency	Basis
Internal reports (monthly)	Accrual basis
Donor reports (quarterly)	Modified basis
Audited accounts (annually)	Accrual basis

## Governance

- Year-end accounts are on the same basis as received during the year. The board has information about assets and liabilities

## External users

- Accrual-based information most useful for a range of users.

## Fraud (double funding)

- Donor reports not readily reconcilable to year-end accounts

## Efficiency

- Considerable effort needed for donor reports (which may be even monthly).

Area	Score	9
Fighting fraud	1	
Reporting efficiency	0	
Governance	4	
External users	4	



# 5.5 Scenario 5

Report and frequency	Basis
Internal reports (monthly)	Accrual basis
Donor reports (quarterly)	Accrual basis
Audited accounts (annually)	Accrual basis

## Governance

- Year-end accounts are on the same basis as received during the year. The board has information about assets and liabilities

## External users

- Accrual-based information most useful for a range of users.

## Fraud (double-funding)

- Donor reports reconcilable to year-end accounts

## Efficiency

- All three types of report are on the same basis, easy to monitor budgets

Area	Score	15
Fighting fraud	3	
Reporting efficiency	4	
Governance	4	
External users	4	

## 5.5 Scenario summary

Report and frequency	1	2	3	4	5
Internal reports (monthly)	Cash	Cash	Modified	Accrual	Accrual
Donor reports (quarterly)	Cash	Cash	Modified	Modified	Accrual
Audited accounts (annually)	Cash	Accrual	Accrual	Accrual	Accrual
Score	8	7	11	9	15

### Commentary

- No scenario considered modified basis audited accounts because no such international standard exists or is under development.
- The modified basis is coloured with a gradient colour, in recognition that it represents a range of practice
- The highest scoring option is Scenario 5. But it is unrealistic and impractical to expect all donors to accept accrual-based reports in the short term.
- The 2<sup>nd</sup> highest scoring option is Scenario 3, and reflects the benefits of a consistent basis for the most frequently produced reports (internal and donors reports).
- The worst possible is the Scenario 2 – a reality for many NPOs! Inadequate information about assets and liabilities, but accrual-based year end reports in accordance IFRS, written with ‘for-profit’ entities in mind!

# 5.6 Why the tool was developed

## Modified basis accounting

- In the short-medium term (until such a time as more donors accept accruals-based reporting), the highest scoring practical alternative in the scenarios analysed is for NPOs and donors to use modified basis accounting and reporting during the year.
- There is currently no internationally accepted tool to help describe or define the spectrum of practice with the modified basis, and provide more clarity for communication between NPOs and their funders.
- Humentum has therefore developed a tool that describes the main types of transactions that organisations or donors may wish to account for or have reported on a cash or accrual basis.

# Section 6

How to use

Accounting Basis:  
Diagnostic and Strategy  
Tool for NPOs and  
funders

# 6.1 How to use the tool - NPOs

- After reading this slide deck for context, download the Excel tool here: [LINK](#)
- For each accounting practice:
  - Refer to the notes for a detailed description and examples
  - Indicate Yes, No or N/A according to whether you currently use that treatment or not.
  - Consider the reason – is it a donor requirement, strategic choice, or do you have a capacity limitation (systems or staff) that prevents you from using your preferred option? If it is policy – what is the reason for the policy?
- Consider which, if any, practices you would like to change, why and when.
- Choose the most appropriate level on the cash to accrual scale (1-7) as shorthand to communicate your current practice internally and externally.
- Take steps as needed, such as negotiating with existing funders for flexibility, or sourcing/allocating funds to enhance capacity.
- NPOs may also use this tool to assess the rules of potential funders (in respect to the accounting basis in financial reports) to assess ‘fit’ with current systems, as part of the decision to accept funding or negotiate terms.

## 6.2 How to use the tool - Funders

- After reading this slide deck for context, download the Excel tool here: [LINK](#)
- For each accounting practice
  - Refer to the notes for a detailed description and examples
  - Indicate whether your reporting guidelines currently require, permit or prohibit each treatment
  - Consider the reason – if it is policy, what is the reason for the policy? Is it to get consistency for analysis, to accommodate the capacity of different grantees, to comply with requirements of back donors?
- Bearing in mind the impact on grantees, consider what if any changes you would like to make to rules with respect to accounting basis in reports, such as increasing flexibility
- Discuss any changes with grantees, including any support to build accounting capacity as relevant.
- Funders may also use this tool to assess the practice of potential grantees to assess ‘fit’ with existing reporting requirements.

## 6.3 Where to find the tool

- The tool can be found here: [LINK](#)