

Section 2 – Concepts and pervasive principles

Scope of this Section

- G2.1 This Section describes the objective of general purpose financial reports of non-profit organisations (NPOs). It also sets out the concepts and basic principles underlying the general purpose financial reports of NPOs.
- G2.2 ~~In some circumstances, there may be inconsistencies between~~ The concepts and principles in this Section ~~might not always align with and~~ the requirements ~~of in~~ other Sections of the Standard. In ~~these circumstances those cases,~~ the requirements in the other Sections take precedence over ~~this the concepts and principles in this~~ Section.

The objective of non-profit organisations' general purpose financial reports

Objective, usefulness and limitations of general purpose financial reports

- G2.3 The objective of general purpose financial reports of an NPO is to provide financial and non-financial information about the NPO that is **useful to existing and potential users of their financial reports** for accountability and decision making.
- G2.4 General purpose financial reports include financial and non-financial information which complements and enhances the information provided in the financial statements. Non-financial information will include the information specified by the requirements in **Section 35 Narrative reporting**.

Users of general purpose financial reports

- G2.5 NPOs are responsible for the stewardship of the resources entrusted to them. NPOs are accountable for the management and use of resources to existing and potential resource providers and to the public that benefit from the goods and services provided by NPOs or the activities that they carry out.
- G2.6 For the purposes of INPAS the primary users of the NPO general purpose financial reports are existing and potential:
- a) resource providers – see paragraph **G2.7**;
 - b) the public that benefit from the goods and services provided by NPOs – see paragraph **G2.8**; and
 - c) those acting as representatives of the interests of resource providers and the public that benefit from the goods and services provided by NPOs – see paragraph **G2.9**
- These primary users will be described as resource providers and the public that benefit from the goods and services provided by NPOs.
- G2.7 NPOs are provided with resources from numerous sources including, for example, donors and other funders, governments, banks, lenders, and creditors. These resource providers (as described in paragraphs **G2.5–G2.6**), will be primary users when they do not have rights to demand information tailored to meet their particular information needs.

- G2.8 The public that benefit from the goods and services provided by the NPO or the activities that they carry out are those that benefit either directly or indirectly from an NPO's activities. They may be referred to as service users or recipients, or clients and can range from an entire population either within a jurisdiction or wider, to a small subset of a community.
- G2.9 The legislative body of a country, state or region (or similar) or members of parliaments or assemblies in a state or region (or similar bodies) will be primary users when acting in the interests of resource providers and the public that benefit from the goods and services provided by NPOs or on the activities that they carry out. This will include individual elected representatives and public officials who have a duty to represent the interests of members of the public who are provided with services and goods by the NPO, or benefit from its activities or who provide it with financial and other resources.
- G2.10 General purpose financial reports are not developed specifically to respond to any individual user's information needs.
- G2.11 When users exercise their rights to demand information tailored to meet their particular information needs, they are not considered to be primary users of general purpose financial reports. For example, some donors or other funders will have the authority to request special purpose financial reports as part of funding arrangements. Information tailored to a user's individual needs would not be included in general purpose financial reports. However, donors and other funders will be primary users when they are not requesting such information.
- G2.12 General purpose financial reports do not and cannot provide all the information that existing and potential users need when making decisions. These users also consider pertinent information from other sources – for example, general economic conditions and expectations, political events and political climate, and sector and individual NPO focused outlooks.

Information needs of users for accountability and decision making

- G2.13 The discharge of accountability obligations requires the provision of information about the NPO's management of its resources in meeting its purposes, its capacity to continue to operate in future periods, and its compliance with any regulations that govern its operations.
- G2.14 Information provided in general purpose financial reports for accountability purposes will also contribute to and inform economic and other decision making (for further discussion on the information needs of users see IG2.3).

Information provided by general purpose financial reports to meet the needs of users

- G2.15 Financial information that is presented in the **financial statements** on an NPO's financial position, its contribution to the surplus or deficit and cashflows will need to be enhanced by financial and non-financial information in general purpose financial reports. The information in general purpose financial reports complements and supplements the financial information presented in the financial statements to fully describe an NPO's performance.

- G2.16 General purpose financial reports include financial statements that provide information about an NPO's financial position, which is information about the NPO's economic resources and the claims against the NPO. Financial statements also provide information about the effects of transactions and other events that change a reporting NPO's **economic resources** and claims. They allow users to make decisions and develop expectations based on their assessment of the amount, timing and uncertainty of the NPO's future net cash inflows.
- G2.17 Financial statements also show how efficiently and effectively the reporting NPO's management has met its responsibility to use its economic resources. This information helps users assess management's stewardship of those resources

Qualitative characteristics of information in general purpose financial reports

- G2.18 An NPO uses the qualitative characteristics of useful financial information described in paragraphs G2.19–G2.34 to identify the types of information likely to be most useful for users when making decisions about the NPO.

Qualitative characteristics of useful financial and non-financial information

- G2.19 Financial information is useful only if it is relevant and faithfully represents what it purports to represent. The usefulness of financial and non-financial information is enhanced if it is comparable, verifiable, timely and understandable.

Fundamental qualitative characteristics

- G2.20 The fundamental qualitative characteristics are relevance and faithful representation.

Relevance

- G2.21 Financial information is relevant if it can influence users' decisions. Information might be relevant even if some users choose not to make use of it or are already aware of it from other sources.
- G2.22 Financial information can affect users' decisions by having predictive value, confirmatory value or both.

Materiality

- G2.23 Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those financial reports, which provide financial and non-financial information about a specific reporting NPO. Materiality is an NPO entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual NPO's financial reports. Consequently, it is not possible to specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

Faithful representation

- G2.24 Financial reports represent economic or other phenomena in words and numbers. Useful financial information not only represents relevant phenomena, but also faithfully represents the substance of the phenomena that it purports to represent. In many circumstances, the substance of an economic or other phenomenon and its legal form are the same. If they are not the same, information only about the legal form would not, by itself, faithfully represent the economic or other phenomenon.
- G2.25 To be a perfectly faithful representation, a depiction of an economic or other phenomenon would have three characteristics. It would be complete, neutral and free from error. Perfection is rarely, if ever, achievable. Instead, the objective of INPAS is to maximise those qualities to the extent possible.
- G2.26 To be complete, a depiction of an economic or other phenomenon includes all information necessary for a user to understand the phenomenon, including all necessary descriptions and explanations.
- G2.27 To be neutral, a depiction of an economic or other phenomenon is without bias in the selection or presentation of financial information. Neutrality is supported by **prudence**, which is the exercise of caution when an NPO makes judgements under conditions of uncertainty. The exercise of prudence means that **assets** and **income** are not overstated and **liabilities** and **expenses** are not understated. Equally, prudence does not allow for the understatement of assets or income or the overstatement of liabilities or expenses. Such misstatements can lead to the overstatement or understatement of income or expenses in future periods. Consequently, some sections of this Standard might contain asymmetric requirements if necessary to help an NPO select the most relevant information that faithfully represents what it purports to represent.
- G2.28 Faithful representation does not mean the depiction of an economic or other phenomenon is accurate in all respects. To be free from error, a depiction of the phenomenon contains no errors or omissions, and an NPO has selected and applied, without errors, a process to produce the information in the financial statements.

Applying the fundamental qualitative characteristics

- G2.29 The most efficient and effective process by which an NPO applies the fundamental qualitative characteristics of financial information, subject to the effects of enhancing characteristics (see paragraph G2.30) and the cost constraint (see paragraphs G2.35–G2.37), is usually:
- first, to identify an economic or other phenomenon, about which information can be useful to users.
 - second, to identify the type of information about the phenomenon in (a) that would be most relevant.
 - third, to assess whether the relevant information in (b) is available and whether it can provide a faithful representation of the economic or other phenomenon. If so, the process of satisfying the fundamental qualitative characteristics ends at that point. If not, the NPO repeats the process with the next most relevant type of information. In some cases, the NPO might have to prioritise one or more of the fundamental qualitative characteristics over others to meet the objective of general purpose financial reports (see paragraph G2.42).

Enhancing qualitative characteristics

- G2.30 Comparability, verifiability, timeliness and understandability are qualitative characteristics that enhance the usefulness of relevant information that provides a faithful representation of what it purports to represent. These enhancing qualitative characteristics might also help an NPO decide how it depicts an economic or other phenomenon if the NPO judges that more than one way provides equally relevant information and an equally faithful representation of that phenomenon.

Comparability

- G2.31 Information about an NPO is more useful if users can compare that information with similar information about other NPOs and with similar information about the same NPO for another period or another date. Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences between, items. Comparability is reduced if NPOs are permitted to use alternative accounting methods for the same phenomenon.

Verifiability

- G2.32 Verifiability helps assure users that information faithfully represents the phenomenon it purports to represent. Verifiability means that knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is faithful. Quantified information does not have to be a single point estimate to be verifiable; a range of possible amounts and the related probabilities can also be verified.

Timeliness

- G2.33 Timeliness means having information available to decision-makers in time for it to be able to influence their decisions. Generally, the older the information, the less useful it is. However, some information may continue to be timely long after the end of a **reporting period** because, for example, some users will use it to identify and analyse trends.

Understandability

- G2.34 Classifying, characterising and presenting information clearly and concisely makes it understandable. However, understandability should not be used as a justification for omitting material information. Financial reports would be incomplete if an NPO excluded information about phenomena because the phenomena are inherently complex and cannot be made easy to understand.

The cost constraint on useful financial reporting

- G2.35 Cost is a pervasive constraint on the information that an NPO can provide. Reporting financial and non-financial information imposes costs on an NPO, so it is important that those costs are justified by the benefits of reporting that information.

- G2.36 NPOs expend most of the effort involved in collecting, processing, verifying and disseminating financial and non-financial information. Users also incur costs of analysing and interpreting the information an NPO provides. If NPOs do not provide needed information, users incur additional costs to obtain that information elsewhere or to estimate it.
- G2.37 Reporting financial and non-financial information that is relevant and faithfully represents what it purports to represent helps users to make decisions with more confidence. However, it is not possible for general purpose financial reports to provide all the information that every user finds relevant.

Undue cost or effort

- G2.38 Some requirements in this Standard are accompanied by an undue cost or effort exemption. Such exemptions do not apply to other requirements in this Standard.
- G2.39 Whether an NPO must spend undue cost or effort to obtain or judge the information necessary to comply with a requirement depends on the NPO's specific circumstances and on management's judgement of the costs and benefits of applying that requirement. To make this judgement, an NPO considers how users' decision-making could be affected by not having that information. An NPO would spend undue cost or effort applying a requirement if the incremental cost (for example, valuers' fees) or additional effort (for example, endeavours by employees) substantially exceeds the benefits users would receive from having the information.
- G2.40 An NPO judges whether a requirement would involve undue cost or effort on initial **recognition** in the financial statements – for example, at the date of the transaction – based on information about the costs and benefits of the requirement at the time of initial recognition. If the undue cost or effort exemption also applies after initial recognition – for example, to a subsequent measurement of an item – the NPO makes a new judgement of undue cost or effort at that subsequent date, based on information available at that date.
- G2.41 If an NPO applies an undue cost or effort exemption, the NPO shall disclose that fact and the reasons why applying the requirement would involve undue cost or effort. This requirement does not apply to the undue cost or effort exemption in paragraph G19.7, which is covered by the disclosure requirements in paragraph G19.38.

General purpose financial reports and the reporting NPO

Objective and scope of general purpose financial reports

- G2.42 The objective of general purpose financial reports is to provide financial information about the reporting NPO's assets, liabilities, net assets, income and expenses, as well as non-financial information that is useful to users for accountability and decision-making purposes, including assessing management's stewardship of the NPO's resources (see paragraphs G2.3–2.17).

Reporting period

- G2.43 An NPO prepares its financial reports for a specified reporting period and discloses information about:
- a) its assets and liabilities, including unrecognised assets and liabilities, net assets and restricted funds and unrestricted funds within net assets that existed at the end of the reporting period or during the reporting period
 - b) its income and expenses for the reporting period.
- G2.44 To help users identify and analyse changes and trends, an NPO also discloses in its financial reports comparative information for at least one preceding reporting period, except if this Standard permits or requires otherwise.
- G2.45 An NPO also discloses in its financial reports information about possible future transactions and events if the information:
- a) relates to the NPO's assets or liabilities, including unrecognised assets or liabilities, net assets and funds within net assets that existed at the end of the reporting period or during the reporting period, or to income or expenses for the reporting period; and
 - b) is useful to users of financial reports.

Perspective adopted in financial reports

- G2.46 An NPO discloses in its financial reports information about transactions and other events from the perspective of the NPO as a whole, not that of any particular group of the NPO's current or potential users.

Going concern assumption

- G2.47 An NPO normally prepares its financial statements on the assumption that it is a going concern and will continue in operation for the foreseeable future. Users assume that the NPO has neither the intention nor the need to enter liquidation or to stop trading. If the NPO has such an intention or need, it might prepare the financial statements on another basis. If so, the NPO describes in its financial statements the basis it has used (see paragraphs G3.8–G3.9).

The reporting NPO

- G2.48 A reporting NPO is an NPO that is required or chooses to prepare general purpose financial reports. A reporting NPO is not necessarily a legal entity. A reporting NPO can be a single NPO or a portion of an NPO or can comprise more than one NPO. It may operate through trusts or other entities, and some of these may have a separate legal identity, autonomy to operate or otherwise support the provision of goods and services.
- G2.49 A reporting NPO will prepare general purpose financial reports as if it were one economic entity or other complete set of activities related to its purposes.
- G2.50 An NPO may have an interest in another entity and be characterised as a **controlling NPO** (parent), while another entity (that may or may not be an NPO) is characterised as a **controlled entity**. Control is the power of an NPO to direct the activities of or use the funds of another entity (see paragraphs G9.8–G9.19).

- G2.51 If a reporting NPO comprises both the controlling NPO and its controlled entities, the reporting NPO's financial statements are referred to as **consolidated financial statements**. If the controlling NPO produces financial statements alone, these are referred to as **separate financial statements**. If the reporting NPO comprises two or more entities that are not linked by a controlling NPO-controlled entity relationship, the reporting NPO's financial statements are referred to as **combined financial statements**.
- G2.52 Determining the appropriate reporting boundary of a reporting NPO can be complex when the potential reporting NPO is not a legal entity or when it does not include legal entities that are governed by controlling NPO-controlled entity relationships.
- G2.53 When a reporting NPO is not easily determined (for example, a reporting NPO will be clear when it is a legal entity or is controlled by a controlling NPO-controlled entity relationship), establishing the boundary of the reporting NPO is driven by the information needs of the users of the reporting NPO's financial statements. Users need relevant information that faithfully represents what it purports to represent. Faithful representation requires that:
- a) the boundary of the reporting NPO does not contain an arbitrary or incomplete set of economic activities;
 - b) including that set of economic activities within the boundary of the reporting NPO results in neutral information; and
 - c) a description is provided of how the boundary of the reporting NPO was determined and of what constitutes the reporting NPO.
- G2.54 Where a reporting NPO is not easily determined, an NPO shall disclose the basis for the reporting NPO boundary, any significant judgements in determining it and its relationship with other entities in the notes to the financial statements.

The elements of financial statements

Introduction

- G2.55 The elements of **financial statements** defined in this Section are as follows:
- a) Assets, liabilities and net assets, which relate to a reporting NPO's **Statement of Financial Position**.
 - b) Income and expenses, which relate to a reporting NPO's **Statement of Income and Expenses** if they contribute to surplus and deficit, and to the **Statement of Changes in Net Assets** if they do not contribute to surplus and deficit.
- G2.56 These elements are linked to the economic resources (see paragraph G2.59), claims and changes in economic resources and claims discussed in paragraphs G2.15–G2.17.
- G2.57 In addition to these elements, further important aspects of NPO financial statements are discussed in this Section. These include:
- a) **equity claims**;
 - b) **restricted funds** and **unrestricted funds**.

Definition of an asset

- G2.58 An **asset** is a present economic resource controlled by the NPO as a result of past events.
- G2.59 An economic resource is a right that has the **potential to produce economic benefits** or to provide services and goods in accordance with the NPO's objectives. Economic benefits relate to cash inflows or a reduction in cash outflows. The capacity to provide services and goods that contribute to achieving the NPO's objectives is **service potential**. Service potential enables an NPO to achieve its objectives without necessarily generating net cash inflows.
- G2.60 Rights that have the potential to produce economic benefits or service potential take many forms, including;
- a) rights that correspond to an obligation of another party, for example:
 - i) rights to receive cash
 - ii) rights to receive services or goods or assign services or goods to third parties
 - iii) rights to exchange economic resources with another party on favourable terms. Such rights include, for example, a forward **contract** to buy an economic resource on terms that are currently favourable or an option to buy an economic resource
 - iv) rights to benefit from an obligation of another party to transfer an economic resource if a specified uncertain future event occurs
 - b) rights that do not correspond to an obligation of another party, for example, **rights over physical assets, such as property, plant and equipment or inventories, or rights over some intangible assets.**
- G2.61 Many rights are established by contract, legislation or similar means. For example, an NPO might obtain rights from owning or leasing a physical object, from owning a debt instrument or an equity claim, or from owning a registered patent. However, an NPO might also obtain rights in other ways, for example:
- a) by acquiring or creating know-how that is not in the public domain; or
 - b) through another party's obligation that arises because that other party has no practical ability to act in a manner inconsistent with its customary practices, published policies or specific statements.
- G2.62 An economic resource is a right that has the potential to produce economic benefits or service potential. It does not need to be certain, or even likely, that the right will produce economic benefits or service potential. It is only necessary that the right already exists.
- G2.63 An **NPO** controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits or service potential that might flow from it. An **NPO** has the present ability to direct the use of an economic resource if it has the right to deploy that economic resource in its activities, or to allow another party to deploy the economic resource in that party's activities. Control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits and service potential that may flow from it.

Definition of a liability

- G2.64 A **liability** is an NPO's present obligation to transfer an economic resource as a result of past events.
- G2.65 A liability exists only if:
- the NPO has an obligation;
 - the obligation is to transfer an economic resource; and
 - the obligation is a present obligation that exists as a result of past events.
- G2.66 An NPO has an obligation if it has a duty or responsibility that the NPO has no practical ability to avoid. An obligation is always owed to another party (or parties). It is not necessary for the NPO to know the identity of the party (or parties) to whom the obligation is owed. Many obligations are established by contract, legislation or equivalent means and are legally enforceable by the party (or parties) to whom they are owed. However, obligations can also arise from an NPO's customary practices, published policies or specific statements if the NPO has no practical ability to act in a manner inconsistent with those practices, policies or statements. The obligation that arises in such situations is sometimes referred to as a **constructive obligation**.
- G2.67 A liability gives rise to an obligation to transfer an economic resource if the obligation has the potential to require an NPO to transfer the economic resource to another party (or parties). It does not have to be certain, or even likely, that the NPO will be required to transfer the economic resource for that potential to exist. It is only necessary that the obligation exists and that, in at least one circumstance, it would require the NPO to transfer the economic resource.
- G2.68 Obligations to transfer an economic resource include, for example:
- obligations to pay cash
 - obligations to provide services or deliver goods
 - obligations to exchange economic resources with another party on unfavourable terms
 - obligations to transfer an economic resource if a specified uncertain future event occurs
 - obligations to issue a **financial instrument** if that financial instrument will oblige the NPO to transfer an economic resource.
- G2.69 Instead of fulfilling an obligation to transfer an economic resource to the party that has a right to receive that resource, an NPO might sometimes decide, for example:
- to settle the obligation by negotiating a release from the obligation;
 - to transfer the obligation to a third party; or
 - to replace that obligation to transfer an economic resource with another obligation by entering into a new transaction.
- G2.70 A present obligation exists as a result of past events only if an NPO:
- has already obtained economic benefits or service potential or taken an action giving rise to the obligation; and
 - will or may have to transfer an economic resource that it would not otherwise have had to transfer.
- G2.70 The economic benefits or service potential obtained could include, for example, goods or services. The action the NPO has taken could include, for example, undertaking a particular activity for the benefit of the public or operating in a particular geographical

area. If the NPO has obtained economic benefits or service potential or has taken action, over time, the resulting present obligation may accumulate over that time.

Assets and liabilities

Unit of account

- G2.71 The **unit of account** is the right or the group of rights, the obligation or the group of obligations, or the group of rights and obligations to which an NPO applies recognition criteria and measurement concepts.
- G2.72 An NPO selects a unit of account for an asset or liability when it considers how recognition criteria and measurement concepts will apply to that asset or liability and to the related income and expenses. In some circumstances, it might be appropriate for the NPO to select one unit of account for recognition and another unit of account for measurement. For example, an NPO might sometimes recognise contracts individually, but measure them as part of a portfolio of contracts. For presentation and disclosure, an NPO might aggregate or separate assets, liabilities, income and expenses into their components.

Executory contracts

- G2.73 An **executory contract** is a contract, or a portion of a contract, that is equally unperformed. Neither party has fulfilled any of its obligations, or both parties have partly fulfilled their obligations to an equal extent.
- G2.74 An executory contract establishes a combined right and obligation to exchange economic resources. The right and obligation constitute a single asset or liability. The NPO has an asset if the terms of the exchange are currently favourable; it has a liability if the terms of the exchange are currently unfavourable. Whether the NPO includes such an asset or liability in its financial statements depends on both the recognition criteria and the measurement basis the NPO selected for the asset or liability, including, if applicable, any test for whether the contract is onerous.

Net assets

- G2.75 Net assets are the residual of recognised assets minus recognised liabilities. Net assets will include specific categories of items whose use may be either with restrictions or without restrictions as per paragraph G2.82.
- G2.76 Some of the net assets of an NPO may not be available to it to achieve its objectives of providing a benefit to the public but instead are a financial interest that is due to the holders of equity claims. Equity claims are the financial interest in the net assets of an NPO that is due to holders of those claims. Where the holders of equity claims have established a financial interest in some of the net assets of the NPO (see paragraphs G2.77–G2.81), the equity claims shall be recognised as a subset of net assets.

Equity Claims in an NPO Context

- G2.77 Equity claims in the NPO context are expected to be rare. An NPO's net assets are anticipated to be used to achieve its objectives, not for distribution. Where equity

claims do exist, they are unlikely to be material by magnitude but may be material by nature.

- G2.78 Where equity claims do exist, they provide a financial interest in the net assets of the NPO through an entitlement to:
- a) distributions of future economic benefits or service potential by the NPO during its life, such distributions being at the discretion of the NPO; and
 - b) distributions of any excess assets over liabilities in the event of the NPO's dissolution where this excess has not otherwise been distributed to another NPO or entity with a similar purpose.

In some cases, this financial interest may be sold, exchanged, transferred or redeemed. Such a financial interest is similar but not the same as the concept of ownership in the IFRS for SMEs Accounting Standard, where investors in equity instruments that provide entitlement to the residual interest in the assets of an entity after deducting all of its liabilities are deemed to be owners.

- G2.79 Investments from holders of equity claims are an inflow of resources to the NPO, contributed by parties external to the NPO as a consequence of equity claim arrangements, that establish or increase a financial interest in the net assets of the NPO. Examples would include the purchase by external parties of share capital issued by the NPO or funds contributed by members that entitle them to a share of net assets.
- G2.80 The provision of funding by an external party that provides governance rights but does not establish a financial interest in the net assets of the NPO is not a contribution from holders of equity claims and does not lead to the recognition of equity claims. Also, if the amount contributed is required to be refunded in the future it will be recognised as a liability in accordance with [Section 22 Liabilities and equity claims](#).
- G2.81 Distributions to holders of equity claims are outflows of resources from the NPO, distributed to parties external to the NPO in accordance with equity claims arrangements, which return or reduce a financial interest in the net assets of the NPO. Examples would include the repurchase from external parties of shares issued by the NPO, or paying funds back to members so that they no longer had a further entitlement to a share of net assets.

Fund Accounting

- G2.82 When assets and liabilities, and corresponding income and expenses, are recognised, they shall be accounted for in an appropriate fund. An NPO may have more than one fund for a variety of reasons. Where this is the case, each fund shall be categorised by an NPO as either restricted funds or unrestricted funds. This allows an NPO to manage and present the elements by individual fund. [Section 36 Fund accounting](#) provides more detail on fund accounting.
- G2.83 Net assets may also feature funds originally recognised as income in the NPO financial statements. These funds might need to be held permanently and cannot be converted into income (and are often described as endowment funds). Only income which can be generated from the capital may be used by the NPO.

Definitions of income and expenses

- G2.84 Income is increases in assets or decreases in liabilities that result in increases in net assets other than those relating to **contributions from holders of equity claims**; and
- G2.85 Expenses are decreases in assets or increases in liabilities that result in decreases in net assets other than those relating to **distributions to holders of equity claims**.
- G2.86 Income and expenses are the elements of financial statements that relate to an NPO's financial activity in a reporting period. Users of financial statements need information about both an NPO's financial position and its financial activity in a reporting period. Although income and expenses are defined in terms of changes in assets and liabilities, information about income and expenses is just as important as information about assets and liabilities.
- G2.87 Transactions and other events generate income and expenses with varied characteristics. Separating information about income and expenses that have differing characteristics can help users understand the NPO's financial activity.

Recognition and derecognition

The recognition process

- G2.88 Recognition is the process of capturing assets, liabilities, net assets, income and expenses in the Statement of Financial Position, Statement of Income and Expenses or the Statement of Changes in Net Assets. Recognition involves depicting the item, either alone or in **aggregation** with other items, in words and by a single monetary amount in one of those statements and including that amount in one or more totals in that statement. The **carrying amount** is the amount at which an NPO recognises an asset, a liability or **net assets** in the Statement of Financial Position.
- G2.89 Recognition links the elements, the Statement of Financial Position, the Statement of Income and Expenses and the Statement of Changes in Net Assets as follows (see Figure 2.1 and Figure 2.2). In the Statement of Financial Position, at the beginning and end of the reporting period, total assets minus total liabilities is equal to net assets. Recognised changes in net assets during the reporting period comprise:
- income minus expenses that contribute to surplus and deficit and that are recognised in the Statement of Income and Expenses; plus
 - income minus expenses that do not contribute to surplus and deficit and that are recognised directly in the Statement of Changes in Net Assets; plus
 - contributions from holders of equity claims minus distributions to holders of equity claims.

Figure 2.1: How recognition links the elements of financial statements

Statement of Financial Position at the beginning of the reporting period Assets minus liabilities equals net assets
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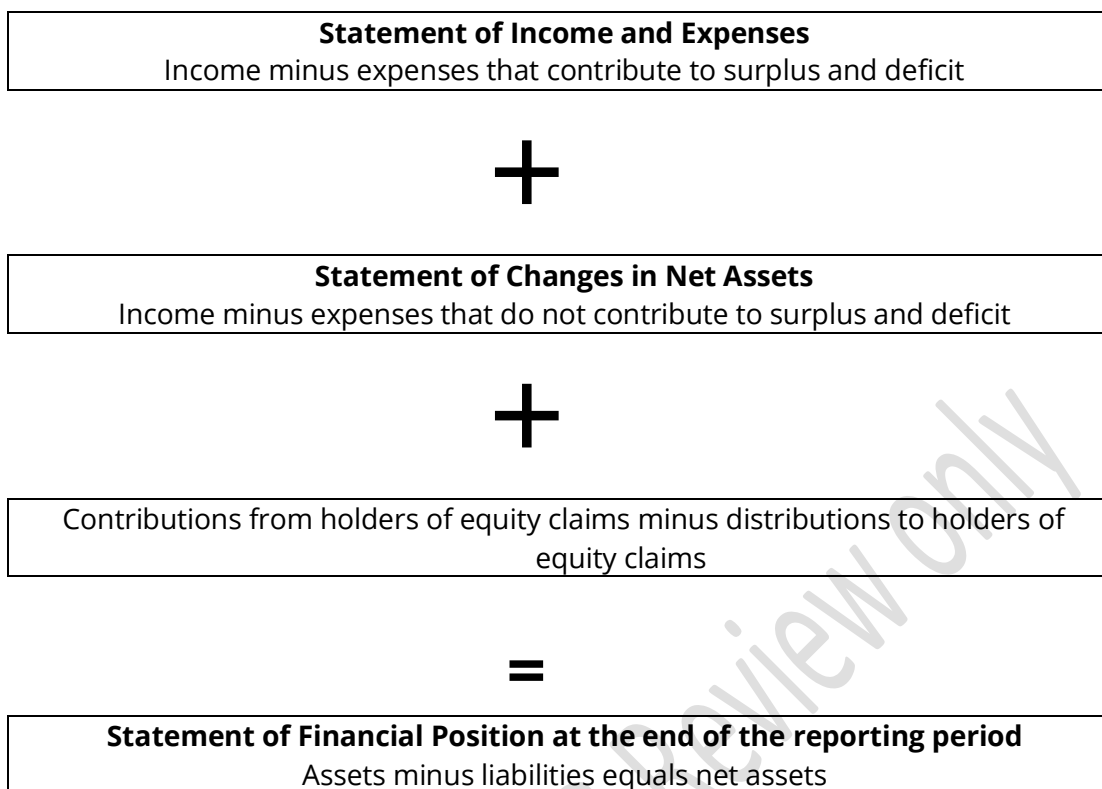


Figure 2.2: How recognition impacts components of net assets

Net assets at the beginning of the reporting period	In reporting period recognition			Net assets at the end of the reporting period
Unrestricted funds	Plus income without restrictions	Minus expenses without restrictions	Plus/minus reclassifications between unrestricted funds and restricted funds	Unrestricted funds
Restricted funds	Plus income with restrictions	Minus expenses with restrictions	Plus/minus reclassifications between unrestricted funds and restricted funds	Restricted funds
Equity claims (where they exist)	Plus contributions from holders of equity claims	Minus distributions to holders of equity claims		Equity claims
Other reserves (revaluation reserves)	Plus (revaluation) increases	Minus (revaluation) decreases		Other reserves (revaluation reserves)

Recognition criteria

- G2.90 Only items that meet the definition of an asset, a liability or net assets are recognised in the Statement of Financial Position. Similarly, only items that meet the definition of income or expenses are recognised in the Statement of Income and Expenses or in the Statement of Changes in Net Assets, depending on whether they contribute to surplus and deficit or not. However, not all items that meet the definition of one of those elements are recognised (see also paragraph G2.92 below).

- G2.91 An NPO cannot correct its failure to recognise an item that satisfies the recognition criteria by disclosing the **accounting policies** it used or by providing notes or explanatory material.

Relevance

- G2.92 Information about assets, liabilities, net assets, income and expenses is relevant to users. However, recognition of a particular asset or liability and any resulting income, expenses or changes in net assets might not always provide relevant information. For example, if it is uncertain whether an asset or liability exists, or if an asset or liability exists but the probability of an inflow or outflow of economic benefits or service potential is low, information about that asset or liability might not be relevant. However, that information could be relevant in combination with other factors.

Existence uncertainty

- G2.93 In some cases, it may be unclear whether an asset or liability exists. That uncertainty, which might coincide with a low probability of inflows or outflows of economic benefits or service potential and an exceptionally wide range of possible outcomes, might mean that recognising a single asset or liability would not provide relevant information. Whether or not an NPO has recognised the asset or liability, the NPO might need to provide explanatory information in the financial statements about the associated uncertainties.

Faithful representation

- G2.94 Recognition of a particular asset or liability is appropriate if it provides not only relevant information but also a faithful representation of that asset or liability and of any resulting income, expenses or changes in net assets. Whether an NPO can provide a faithful representation might be affected by the level of measurement uncertainty associated with the asset or liability or by other factors.

Measurement uncertainty

- G2.95 An NPO measures an asset or liability in order to recognise it. In many cases, an NPO estimates this measurement and it is therefore subject to measurement uncertainty. Using estimates is an essential part of preparing financial information and does not undermine the usefulness of the information if an NPO clearly and accurately describes and explains the estimates.
- G2.96 An item that fails to meet the recognition criteria might later qualify for recognition as a result of circumstances or events.
- G2.97 Whether or not an NPO recognises an asset or liability, the NPO might need to include explanatory information to provide a faithful representation of the asset or liability. The NPO could include information about the uncertainties associated with the asset or liability's existence or measurement, or with its outcome – the amount or timing of any inflow or outflow of economic benefits that will ultimately result from the asset or liability (see paragraphs G2.130–G2.131).

Derecognition

- G2.98 **Derecognition** is the removal of all or part of a recognised asset or liability from an NPO's Statement of Financial Position. Derecognition normally occurs if that item no longer meets the definition of an asset or liability. For example:
- a) for an asset, derecognition normally occurs if the NPO loses control of all or part of the recognised asset; and
 - b) for a liability, derecognition normally occurs if the NPO no longer has a present obligation for all or part of the recognised liability.
- G2.99 Accounting requirements for derecognition in this Standard aim for an NPO to faithfully represent both any asset and liabilities it retained after the transaction or other event that led to derecognition and the change in the NPO's assets or liabilities as a result of that transaction or other event.
- G2.100 To achieve the aim described in paragraph G2.99, an NPO normally:
- a) derecognises any assets or liabilities that have expired or have been consumed, collected, fulfilled or transferred, and recognises any resulting income and expenses; and
 - b) continues to recognise any retained assets or liabilities.
- G2.101 To achieve the aim described in paragraph G2.99, an NPO can:
- a) present the retained component separately in the Statement of Financial Position;
 - b) present separately in the Statement of Income and Expenses any income and expenses that contribute to surplus and deficit recognised as a result of the derecognition of the transferred component;
 - c) present separately in the Statement of Changes in Net Assets any income and expenses that do not contribute to surplus and deficit recognised as a result of the derecognition of the transferred component; or
 - d) provide explanatory information.

Measurement

- G2.102 An NPO quantifies elements recognised in financial statements in monetary terms. To quantify an element, an NPO first selects a measurement basis.
- G2.103 A measurement basis is an identified feature – for example, historical cost, **fair value** or fulfilment value – of an item being measured. Applying a measurement basis to an asset or liability creates a measure for that asset or liability and for related income and expenses.
- G2.104 The appropriate measurement basis is specific to the item being measured.

Measurement bases

Historical cost

- G2.105 Historical cost measures provide monetary information about the assets, liabilities and related income and expenses using information derived, at least in part, from the price of the transaction or other event that gave rise to them.

- G2.106 The historical cost of an asset when it is acquired or created is the value of the costs incurred in acquiring or creating the asset, comprising the consideration paid to acquire or create the asset plus **transaction costs**. The historical cost of a liability is the value of the consideration the NPO received to incur or take on the liability minus transaction costs.
- G2.107 An NPO updates over time the historical cost of an asset to depict, if applicable:
- a) the consumption of part or all of the economic resource that constitutes the asset (depreciation or amortisation);
 - b) any payments received for part or all of the asset;
 - c) the effect of events that cause part or all of the historical cost of the asset to no longer be recoverable (impairment); and
 - d) accrual of interest to reflect any financing component of the asset.
- G2.108 An NPO updates over time the historical cost of a liability to depict, if applicable:
- a) fulfilment of part or all of the liability – for example, by making payments that diminish part or all of the liability or by satisfying an obligation to deliver services or goods.
 - b) the effect of events that increase the value of the obligation to transfer the economic resources needed to fulfil the liability to the extent that the liability becomes onerous. A liability is onerous if the historical cost is no longer enough to depict the obligation to fulfil the liability.
 - c) the accrual of interest to reflect any financing component of the liability.
- G2.109 One way an NPO applies a historical cost measurement basis to **financial assets and financial liabilities** is to measure them at **amortised cost**. The **amortised cost of a financial asset or financial liability** reflects estimates of future cash flows discounted at the rate the NPO determined at initial recognition. For variable rate instruments, the NPO updates the discount rate to reflect changes in the variable rate. Over time, the NPO updates the amortised cost of a financial asset or financial liability to depict changes such as the accrual of interest, the impairment of a financial asset and receipts or payments.

Current value

- G2.110 Measurements based on current value provide monetary information about assets, liabilities and related income and expenses using information updated to reflect conditions at the measurement date. Current value measurement bases include:
- a) fair value;
 - b) current cost;
 - c) **value in use** for assets; and
 - d) fulfilment value for liabilities.
- G2.111 **Fair value** is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between **market participants** at the measurement date. Because fair value is not derived, even in part, from the price of the transaction or other event that gave rise to the asset or the liability, fair value is not increased by transaction costs an NPO incurs when acquiring the asset and is not decreased by the transaction costs an NPO incurs when it takes on the liability.

- G2.112 Current cost is the cost of an equivalent asset at the measurement date, comprising the consideration an NPO would pay at the measurement date plus the transaction costs the NPO would incur at that date. The current cost of a liability is the consideration an NPO would receive for an equivalent liability at the measurement date minus the transaction costs the NPO would incur at that date.
- G2.113 Value in use is the **present value** of the cash flows or other economic benefits or **service potential** that an NPO expects to derive from the use of an asset and from its ultimate disposal. Fulfilment value is the present value of the cash or other economic resources that an NPO expects to be obliged to transfer when it fulfils a liability. Because value in use and fulfilment value are **usually** based on future cash flows, they do not include transaction costs incurred when an NPO acquires an asset or takes on a liability.

Information provided by particular measurement bases

- G2.114 When an NPO selects a measurement basis, it considers the nature of the information that the measurement basis will produce in the Statement of Financial Position, the Statement of Income and Expenses or the Statement of Changes in Net Assets.

Historical cost

- G2.115 If an NPO measures an asset or liability at historical cost, the resulting information might be relevant to users because historical cost uses information derived, at least in part, from the price of the transaction or other event that gave rise to the asset or liability. Because an NPO reduces historical cost to reflect consumption of an asset and its impairment, the amount expected to be recovered from an asset measured at historical cost is at least as great as its carrying amount. Similarly, because an NPO increases the historical cost of a liability when the liability becomes onerous, the value of the obligation to transfer the economic resources needed to fulfil the liability is no more than the carrying amount of the liability.

Current value

- G2.116 If an NPO measures an asset or liability at fair value, the resulting information might have predictive value because fair value reflects market participants' current expectations about the amount, timing and uncertainty of future cash flows.
- G2.117 If an NPO measures an asset using value in use, the resulting information is about the present value of the estimated cash flows or **service potential** from the use of the asset and from its ultimate disposal. This information might have predictive value because it can be used in assessing the prospects for future net cash inflows or **service potential** generated by an asset.
- G2.118 If an NPO measures a liability using fulfilment value, the resulting information is about the present value of the estimated cash flows needed to fulfil the liability. This information might have predictive value, particularly if the NPO expects to fulfil the liability instead of transferring it or settling it by negotiation.
- G2.119 If an NPO provides updated estimates of value in use or fulfilment value, combined with information about estimates of the amount, timing and uncertainty of future cash

flows, that information might help verify previous estimates of value in use or fulfilment value.

- G2.120 If an NPO measures an asset or liability using current cost, the resulting information might be relevant because current cost reflects the cost at which an equivalent asset could be acquired or created at the measurement date or the consideration that would be received from incurring or taking on an equivalent liability.

Factors to consider when selecting a measurement basis

- G2.121 When an NPO selects a measurement basis for an asset or liability and for the related income and expenses, the NPO considers the nature of the information that the measurement basis will produce in the Statement of Financial Position, the Statement of Income and Expenses or the Statement of Changes in Net Assets.
- G2.122 In most cases, an NPO will not select a measurement basis based on a single factor. The relative importance of each factor will depend on facts and circumstances.
- G2.123 An NPO selects a measurement basis that will provide useful information to users. To be useful, the information is relevant and faithfully represents what it purports to represent. In addition, the information should be comparable, verifiable, timely and understandable, to the extent possible.

Relevance

- G2.124 The relevance of information an NPO provides using a measurement basis is affected by:
- a) the characteristics of the asset or liability, in particular whether it is held for its service potential rather than to generate cash flows, the variability of cash flows, and whether the value of the asset or liability is sensitive to market factors or other risks; and
 - b) how that asset or liability contributes to future cash flows.
- G2.125 If the value of an asset or liability is sensitive to market factors or other risks, or if the asset is held for its service potential, its historical cost might differ significantly from its current value. Consequently, historical cost may not provide relevant information if information about changes in value is important to users of financial statements.
- G2.126 For assets and liabilities that produce cash flows directly, such as assets that can be sold independently and without a substantial economic penalty (for example, without a substantial disruption to an NPO's activities), the measurement basis that provides the most relevant information is likely to be a current value that takes into account current estimates of the amount, timing and uncertainty of the future cash flows. For assets and liabilities that do not produce cash flows directly, such as assets held for their service potential, the principles of relevance and faithful representation should be considered to the extent that they apply to the facts and circumstances.
- G2.127 If an NPO's activity involves managing financial assets and financial liabilities with the objective of collecting contractual cash flows, amortised cost may provide relevant information that can be used to derive the margin between the interest earned on the assets and the interest incurred on the liabilities.

Faithful representation

- G2.128 In some circumstances, an NPO uses the same measurement basis for related assets and liabilities to provide users with more useful information than the information that would result from using different measurement bases, for example, if the NPO's cash flows from one asset or liability are directly linked to its cash flows from another asset or liability.
- G2.129 As noted in paragraph G2.25, although a perfectly faithful representation is free from error, measures do not have to be perfectly accurate.
- G2.130 Measurement uncertainty arises if an NPO estimates an item's value because it cannot measure the item by observing prices in an **active market**. The level of measurement uncertainty associated with a particular measurement basis might affect whether the information an NPO provides using that measurement basis is a faithful representation of the NPO's financial position and income and expenses. A high level of measurement uncertainty does not necessarily prevent an NPO from using a measurement basis that provides relevant information, but in some cases, the level is so high that such information might not lead to a sufficiently faithful representation. In these cases, an NPO should consider selecting another measurement basis that would also result in relevant information.
- G2.131 Measurement uncertainty is not the same as **outcome uncertainty** and **existence uncertainty**. Outcome uncertainty arises when there is uncertainty about the amount or timing of any inflow or outflow of economic benefits or service potential that will result from an asset or liability. Existence uncertainty arises when an asset or a liability's existence is uncertain. Paragraphs G2.92–G2.93 discuss how existence uncertainty might affect an NPO's decisions to recognise an asset or liability when the NPO is uncertain about whether that asset or liability exists.

Enhancing qualitative characteristics and the cost constraint

- G2.132 The enhancing qualitative characteristics of comparability, understandability and verifiability, and the cost constraint have implications for an NPO's selection of a measurement basis. The enhancing qualitative characteristic of timeliness has no specific implications for measurement.
- G2.133 Consistently using the same measurement bases for the same items, either from period to period within a reporting NPO or in a single period across NPOs, can help make financial reports more comparable.
- G2.134 If an NPO changes the measurement basis it uses, its financial reports might be less understandable. However, a change might be justified if, for example, the change results in more relevant information. If an NPO changes the measurement basis it uses, users might need explanatory information to understand the effect of that change.
- G2.135 Understandability depends partly on how many different measurement bases an NPO uses and whether its use of those bases changes over time. In general, the more measurement bases an NPO uses, the more complex the resulting information. Consequently, the information becomes less understandable, and the totals or

subtotals in the Statement of Financial Position, the Statement of Income and Expenses or the Statement of Changes in Net Assets become less informative. However, it could be appropriate for an NPO to use more measurement bases if doing so provides useful information.

- G2.136 Verifiability is improved when an NPO uses measurement bases that result in information that can be independently corroborated, either directly (for example, by observing prices) or indirectly (for example, by checking inputs to a model). If a measure cannot be verified, an NPO might provide explanatory information to enable users to understand how the NPO determined the measure.

Measurement of net assets

- G2.137 Net assets equal the total of the carrying amounts of all recognised assets less the total of the carrying amounts of all recognised liabilities.
- G2.138 In the rare circumstances where an NPO has equity claims, it may be appropriate to directly measure the carrying amount of some individual classes and/or components of net assets.

Presentation and disclosure

Presentation and disclosure as communication tools

- G2.139 A reporting NPO communicates information about its assets, liabilities, net assets and funds with and without restrictions in net assets, income and expenses by presenting and disclosing information in its financial reports.
- G2.140 An NPO that effectively presents and discloses information in its financial reports makes that information more relevant, understandable and comparable. Effective presentation and disclosure also contribute to faithful representation of the NPO's assets, liabilities, net assets, income and expenses.
- G2.141 Decisions on the selection, location and organisation of information are made in response to the information needs of users. User information needs should underpin:
- information selection for the financial reports, in particular information about the financial position, income and expenses and cash flows of an NPO;
 - the location of information in the financial reports, which may affect the way that users interpret information; and
 - organisation of information, including decisions on the use of cross-referencing, tables, graphs, headings, numbering and the arrangement of items within a particular component of a report, including decisions on item order.
- G2.142 Just as cost constrains other financial reporting decisions, it also constrains decisions about presentation and disclosure. When an NPO decides how to present and disclose information, it is important that the NPO considers whether the benefits to users justify the costs of providing and using that information.

Classification

- G2.143 **Classification** is the sorting of assets, liabilities, net assets, , income or expenses on the basis of shared characteristics for presentation and disclosure purposes. Such characteristics include but are not limited to the nature of the item, its role (or function) within the activities conducted by the NPO and how it is measured.
- G2.144 Classifying dissimilar assets, liabilities, net assets, income or expenses together can obscure relevant information, reduce understandability and comparability, and may not provide a faithful representation of what it purports to represent.
- G2.145 An NPO applies the classification to the unit of account the NPO selected for an asset or liability. However, an NPO separates an asset or liability's components by characteristic and classifies those components separately if the resulting financial information is more useful.
- G2.146 An NPO classifies income and expenses and includes them in either:
- a) the Statement of Income and Expenses if they contribute to surplus and deficit; or
 - b) the Statement of Changes in Net Assets if they do not contribute to surplus and deficit.
- G2.147 The Statement of Income and Expenses is the primary source of information about an NPO's financial activity for the reporting period. All income and expenses are, in principle, included in that statement if they contribute to surplus and deficit. Income or expenses are to be included in the Statement of Changes in Net Assets if they do not contribute to surplus and deficit when explicitly permitted or required by this Standard. This results in the Statement of Income and Expenses providing more relevant information or providing a more faithful representation of the NPO's financial activity for that period.
- G2.148 Individual Sections of this Standard might describe situations where income and expenses resulting from the changes in the current value of assets and liabilities are included in the Statement of Income and Expenses or the Statement of Changes in Net Assets.

Offsetting

- G2.149 Offsetting occurs when an NPO recognises and measures both an asset and liability as separate units of account but groups them into a single net amount in the Statement of Financial Position. Offsetting classifies dissimilar items together and therefore is generally not appropriate unless required or permitted by a specific Section of this Standard.

Classification of components net assets

- G2.150 To provide useful information, it may be necessary, where relevant for an NPO, to classify components of net assets separately if those components have different characteristics or are subject to particular legal, regulatory or other requirements.
- G2.151 Similarly, to provide useful information, where an NPO manages net assets in separate funds, classifying net assets between restricted funds and unrestricted funds and providing an explanation of the nature and purpose of the restricted funds will provide useful information.

Aggregation

- G2.152 Aggregation is the adding together of assets, liabilities, net assets income or expenses that have shared characteristics and are included in the same classification.
- G2.153 Aggregation makes information more useful by summarising a large volume of detail. However, aggregation conceals some of that detail. An NPO balances its use of aggregation so that relevant information is not obscured either by too little or too much detail.

Comparison of Section 2 with the *IFRS for SMEs Accounting Standard*

Section 2 of INPAS has been drawn from Section 2 of the *IFRS for SMEs Accounting Standard*. The main differences between Section 2 of the Third edition of the *IFRS for SMEs Accounting Standard* and Section 2 of INPAS are as follows:

- INPAS Section 2 provides a description of the primary users of NPO general purpose financial reports, their information needs for accountability and decision-making purposes, and how the information provided by general purpose financial reports meets the needs of users.
- INPAS Section 2 describes the reporting NPO and provides additional guidance on how to determine the reporting NPO and its reporting boundary.
- INPAS Section 2 introduces the concept of service potential in the definition of elements, where service potential relates to the capacity to provide services that contribute to achieving the NPO's objectives without necessarily generating net cash inflows.
- The concept of ownership implied from equity in the private sector does not apply to non-profit organisations that operate for the benefit of service beneficiaries rather than for private distributions.
- Financial interests in the net assets held by private individuals are instead defined as equity claims. Equity claims are a subset of net assets as, given the characteristics of NPOs, equity claims are not expected to be the most significant claim on an NPO's net assets.
- Net assets are defined as the residual of recognised assets minus recognised liabilities available to the NPO to achieve its objectives.
- INPAS Section 2 amends the IFRS for SMEs Accounting Standard's recognition process for income and expenses to reflect that some income and expenses contribute to surplus and deficit, and some are instead recognised in the Statement of Changes in Net Assets.
- INPAS Section 2 includes some presentation principles from IPSAS in relation to decisions on the selection, location and organisation of information in response to users' information needs.

Section 2 – Concepts and pervasive principles

History and background

- BC2.1 INPAS uses the *IFRS for SMEs* Accounting Standard as its foundational framework. Where the existing *IFRS for SMEs* Accounting Standard has not comprehensively or appropriately addressed NPO-specific financial reporting issues INPAS may differ from the *IFRS for SMEs* Standard. INPAS has been developed using the “[Process for developing the International Non-Profit Accounting Guidance through changes to the IFRS for SMEs Standard \[ADD LINK\]](#)”. This allows for the use of:
- IFRS Accounting Standards and their conceptual framework (the IASB’s revised Conceptual Framework for Financial Reporting March 2018); and
 - International Public Sector Accounting Standards (IPSAS) and their conceptual framework (the IPSASB Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities December 2023)
- where this can offer more appropriate financial reporting guidance in the NPO context.
- BC2.2 A number of responses to the IFR4NPO Consultation Paper indicated that the conceptual basis of the *IFRS for SMEs* Accounting Standard was inappropriate for NPOs as it is based on the needs of users of general purpose financial statements of for-profit entities and not NPOs. At the time that the Consultation Paper was issued it was also the case that the Section on Concepts and pervasive principles contained in the *IFRS for SMEs* Accounting Standard published in 2015 did not reflect changes made to the conceptual framework that underpins IFRS Accounting Standards. The Third edition of the *IFRS for SMEs* Accounting Standard has now incorporated the changes made to the conceptual framework that underpins IFRS Accounting Standards.
- BC2.3 The Consultation Paper explained that there are insufficient resources available to the IFR4NPO project to develop an entirely new conceptual framework for NPO financial reporting. INPAS uses relevant aspects of the IASB’s Conceptual Framework that were included in the *IFRS for SMEs* Accounting Standard where these are suitable for use in the NPO context. INPAS also draws upon the IPSASB’s Conceptual Framework to establish the concepts and principles needed to develop financial reporting guidance for NPOs where these are not comprehensively or appropriately addressed in the existing *IFRS for SMEs* Accounting Standard.
- BC2.4 As such aspects of both the IASB and IPSASB’s conceptual frameworks have been used in developing Section 2 *Concepts and pervasive principles* for INPAS.

The objective of non-profit organisations’ general purpose financial reports

Users of general purpose financial reports

- BC2.5 The Consultation Paper focused on the external stakeholders to whom NPOs are accountable, and their information needs. Stakeholders were identified as service users, resource providers, regulators, and broader society. Some respondents were also of the view that internal stakeholders are important in the NPO context. Examples of internal stakeholders provided by these respondents included those charged with governance, staff, and members.

- BC2.6 Stakeholders who may traditionally be seen as internal in nature are important for NPOs. However, the conceptual bases of international frameworks for general purpose financial reporting define primary users as those that do not possess the authority to require an entity to disclose the information they need. The internal stakeholders raised by respondents to the Consultation Paper, including those charged with governance and staff, are likely to possess the authority to require an entity to disclose information to meet their own specific information needs.
- BC2.7 The Practitioner Advisory Group and the Technical Advisory Group (TAG) discussed internal stakeholders as primary users. Group members acknowledged that internal stakeholders would be likely to possess the authority to require an NPO to disclose the information they need for accountability and decision-making purposes. In this regard, they are akin to some external stakeholders, regulatory bodies, and major donors, who are also likely to possess this authority in certain circumstances.
- BC2.8 International financial reporting frameworks indicate that those who possess the authority to require an entity to disclose the information they need are not the primary users of general purpose financial reports even if they may find the information contained within them useful. It was therefore concluded in Exposure Draft 1 that the primary users of NPO general purpose financial reports are the public to whom the NPO provides services and goods or for whom it carries out activities and those resource providers who do not possess the authority to require an NPO to disclose the information they need for accountability and decision-making purposes.
- BC2.9 Exposure Draft 1 (ED1) described primary users as also including those that fulfil oversight functions on behalf of the public and resource providers. This was expected to include elected representatives and public officials who have a duty to represent the interests of members of the public who depend on goods and services provided by the NPO, or the activities that they carry out, or who provide it with financial and other resources.
- BC2.10 Respondents to ED1 agreed with the range of primary users and the description of their needs in Section 2. They agreed that the user categories covered the breadth of stakeholders that use general purpose financial reports, including the public that depend on the goods and services provided by NPOs.
- BC2.11 Respondents commented on the diverse types of donors, providers of grants and other funders and the differing information needs of these users depending on the circumstances. The needs of donors (and other funders) are complex because in some circumstances they may only have access to generally available information and in other circumstances they may be able to require information to be tailored to meet their particular needs. Both of the project's advisory groups underlined the importance of donors and other funders as primary users. Donors and other funders are likely to be acting as primary users when using the information for purposes such as due diligence but not when they have the rights to require special purpose financial reports.
- BC2.12 In response to feedback on the initial Consultation Paper, the INPAS Secretariat agreed to consider the development of separate guidance to meet the specific needs of individual donors. INPAS Practice Guide 1 *Supplementary Statements for donor reporting* was subsequently developed to allow NPOs to present key financial information about a specific activity, project or grant (or projects/grants). This is intended to be useful for

grantor accountability purposes and provide a harmonised approach to special purpose reports. The Practice Guide together with Section 2 and its Implementation Guidance address the differing needs of donors as users.

- BC2.13 Respondents commented on the role of those “fulfilling oversight roles”, which highlighted confusion with their roles as regulators and as a consequence whether they were primary users. Governments in their role as regulators have the authority to require NPOs to disclose information they need for accountability and decision-making purposes and therefore are not primary users in this context. Conversely, when they represent the interests of members of the public who depend on goods and services provided by an NPO or the activities they carry out, or resource providers, then they are acting as primary users. This has been clarified in Section 2.
- BC2.14 In response to requests for additional clarifications, the Secretariat has amended Section 2 to include explicit reference to lenders and other creditors and the Section 2 Implementation Guidance addresses the information requirements of resource providers and the public that benefit from an NPO’s activities.

Qualitative characteristics of information in general purpose financial reports

- BC2.15 The qualitative characteristics of financial information are set out in conceptual frameworks to identify the types of information that are likely to be most useful to users of financial reports for accountability and decision-making. The qualitative characteristics provide a coherent framework for determining the decision usefulness of financial reporting information, guidance on what to do when qualitative characteristics may be in conflict, and overall cost-benefit constraints on financial reporting.
- BC2.16 The *IFRS for SMEs* Accounting Standard provides explanations of the qualitative characteristics of information in financial statements. These qualitative characteristics match those of the revised IASB Conceptual Framework which underpins the development of IFRS Accounting Standards. They are also consistent with the broader scope of general purpose financial reporting in the IPSASB’s Conceptual Framework.
- BC2.17 The qualitative characteristics in the *IFRS for SMEs* Accounting Standard are appropriate in the NPO context. They are therefore considered appropriate for use in the concepts and pervasive principles of the INPAS.

Materiality

- BC2.18 The Exposure Drafts for the development of INPAS have led to questions over the application of materiality to the various proposals and issues on which comments were sought. For example, respondents to Exposure Drafts 2 and 3 have raised issues relating to low value inventory items and to the fund accounting proposals, including whether thresholds should be set. As a pervasive principle materiality guidance does not need to be repeated for each of the INPAS sections. Consequently, additional Implementation Guidance is included in Section 2, drawing on the IASB’s Practice Note 2 *Making Materiality Judgements*.
- BC2.19 The Implementation Guidance covers the following issues:

- The assessment of primary users' information requirements, including the importance of the need to consider both existing and potential users.
- That materiality is pervasive to the application of INPAS across general purpose financial reports, ie that it applies to recognition, measurement, presentation and disclosure.
- That materiality factors are both quantitative and qualitative, including a discussion of how those factors might apply.
- The impact of materiality on presentation and disclosure, and
- How materiality interacts with regulatory requirements.

BC2.20 As materiality is a pervasive issue for general purpose financial reports, it will be important that when taking decisions about materiality an NPO considers users' needs.

Undue cost or effort

- BC2.21 The revised IFRS for SMEs Accounting Standard retains an undue cost or effort exemption. Implementation Guidance has been developed to promote the correct use of the exemption. This Implementation Guidance notes that the exemptions relate to the cost or effort required to obtain or determine, the information necessary to comply with a requirement which will depend on the NPOs specific circumstances, management's judgement on the costs and benefits from applying that requirement, and the information available at the time of the assessment.
- BC2.22 The Implementation Guidance also makes clear that NPOs should not treat the undue cost or effort exemptions as accounting policy choices and that NPOs need to disclose when they have used the exemption and the reasons why applying the requirement would in management's judgement involve undue cost or effort.
- BC2.23 Respondents to ED1 expressed agreement with the approach to the undue cost or effort exemption in Section 2. However, they also highlighted tensions related to its use. While the exemption aims to ease the reporting burden, concerns were expressed about the practical challenges arise, including the need for subjective judgments and assessing costs versus benefits. Respondents also raised concerns about potential misuse. Acknowledging that technical skills are required to make such judgments there is no NPO-specific reason to remove the exemption from INPAS.

General purpose financial reports and the reporting NPO

The reporting NPO

- BC2.24 The Consultation Paper considered the definition of the reporting NPO and its links to both the definition of control and the sometimes complex operational structures of NPOs. This included the use of local offices or administrative units that operate as branches of the NPO, that might be established by NPOs to reach local communities and the recipients of the goods and services provided by NPOs.
- BC2.25 Exposure Draft 1 provided additional guidance to assist in the identification of the reporting NPO after discussion with focus groups. The guidance can assist in identifying an NPO as a reporting entity where there is no legal entity nor a group/parent structure.

- BC2.26 Implementation Guidance includes illustrative examples which examine different operating structures. These examples provide suggestions for the questions and analysis needed to determine the boundary and transactions included in the reporting NPO's financial statements.
- BC2.27 The Basis for Conclusions for Section 9 *Consolidated and Separate Financial Statements* provides a commentary on control in an NPO context, which is relevant in determining the reporting NPO.
- BC2.28 As noted in the Preface, the decision on which entities are required or permitted to use the INPAS rests with legislative and regulatory authorities and standard setters in individual jurisdictions. As such, the reporting NPO for the purpose of applying the INPAS could also be any entity that relevant authorities deem to be an NPO and require or permit it to prepare general purpose financial reports.

The elements of financial statements

Net assets and equity claims in an NPO context

- BC2.29 The *IFRS for SMEs* Accounting Standard follows the IASB Conceptual Framework in including equity as an element of financial statements. The *IFRS for SMEs* Accounting Standard and the IASB Conceptual Framework define equity as the residual interest in the assets of the entity after deducting all its liabilities, and it effectively encompasses all net assets. The term equity implies a formal ownership structure with holders of equity being entitled to financial returns and the residual of net assets based on that ownership. This is unlikely to reflect the reality of the majority of NPOs, where such considerations either will not exist or such ownership interests are likely to be inconsequential.
- BC2.30 Although the term 'equity' and its association with ownership is unlikely to be relevant for most NPOs, ED1 took the position that there does need to be an element that reflects the possibility of a party external to the NPO having a financial interest in the net assets of the NPO.
- BC2.31 The IPSASB faced a similar challenge in the development of its Conceptual Framework. It decided that reference to ownership was appropriate in the public sector context. The IPSASB Conceptual Framework defined ownership contributions as an element, which establishes or increases an interest in the net assets of an entity, and ownership distributions, which return or reduce that interest. The Secretariat examined the approach taken by the IPSASB and the possibility of the development of an element defined as contributed capital to reflect that parties external to the NPO may have a financial interest in the net assets of the NPO. Net assets was not initially considered to be a financial statement element.
- BC2.32 Following discussion with the TAG members, the Secretariat's initial decision was to retain the element of equity rather than create a new element to reflect the same underlying concept. ED1 therefore included equity as a financial statement element, with the Application Guidance providing additional detail on its use in the NPO context.

- BC2.33 Although the majority of the TAG members agreed with the overall approach to the inclusion of equity as an element and the use of restricted and unrestricted funds to present accumulated surpluses, one member disagreed. They were concerned that the elements might not adequately capture the transactions and economic events, and in particular equity as defined in the NPO context.
- BC2.34 Most respondents were supportive of the proposals for equity included in ED1. However, there were several who disagreed for a number of different reasons. Some argued that equity as defined could not exist for an NPO at all as this would mean the entity was for-profit. Others noted that INPAS should use the same definition of equity as *IFRS for SMEs* Accounting Standard (ie the residual interest in the assets of the entity after deducting all its liabilities), with no need to introduce a separate concept for NPOs.
- BC2.35 The Secretariat agreed that there were issues with the ED1 proposals, which became particularly apparent following the Secretariat's initial work on modifying Section 22 *Liabilities* and equity to align with other INPAS Sections. At the heart of this issue was the need for clarity on the characteristics of equity instruments for NPOs, and the extent to which these provide ownership and/or entitlement to the net assets of an NPO. Questions then arose about what kinds of financial instrument might be classified as a liability or equity, and how equity as defined in Section 22 of the *IFRS for SMEs* Accounting Standard interacts with Section 2.
- BC2.36 The Secretariat conducted a survey to gain a better understanding of what kinds of equity instruments NPOs might have and what entitlements they give to holders of equity claims. This provided a range of responses. While some respondents indicated that there was the possibility of share capital or a similar form of equity, these did not appear to provide an entitlement to anything other than a return of funds. As such they appeared more similar conceptually to liabilities.
- BC2.37 The Secretariat further examined the interplay between ownership and equity and the position of net assets. This included focusing on the extent to which external parties obtained control over the NPO when they provide funding to the NPO and whether this established a financial interest in the net assets of the NPO.
- BC2.38 TAG members agreed that the Secretariat needed to revisit the guidance related to equity included in ED1. They also agreed that INPAS defines net assets as a financial statements element and that the Secretariat should examine the definition of equity.
- BC2.39 The Secretariat subsequently updated the definition of net assets as a financial statement element, so that it is 'the residual available to the NPO to achieve its objectives after deducting all its liabilities from its assets'. Equity claims were to be part of net assets when a financial interest in the net assets of the NPO exist because of equity arrangements.
- BC2.40 TAG members were supportive of the changes and rather than redefine equity concluded it would be preferable to refer to equity claims in the NPO context. Equity claims were defined as the financial interest in the net assets of an NPO that is due to holders of those claims. Application Guidance was added to reflect these changes. Respondents to ED3 supported these revised definitions.

BC2.41 Exceptionally, an NPO may need to recognise and present non-controlling interests. As the Secretariat expects such circumstances to be rare, Section 2 did not include a detailed description of such interests. Where an NPO does recognise and present any non-controlling interest, this will also form part of net assets. The Preface and Section 10 set out the additional sources of guidance that can be used should an NPO have a non-controlling interest.

Fund accounting

BC 2.42 NPOs are often provided with financial resources where the provider of those resources restricts the use to specific purposes or activities. INPAS includes these financial resources as restricted funds. Restricted funds will include these amounts only if there is an externally imposed basis for them being set aside. This could be, for example, a legal requirement which guarantees a specific return on the contributions provided by holders of equity claims. Unrestricted funds are other financial resources, including those that the NPO internally designates itself to specific purposes or activities. Restricted and unrestricted funds will reflect accumulated surpluses or deficits. An NPO will present funds as a component of net assets, but they are not a separate financial statement element.

BC2.43 Section 36 *Fund accounting* includes the definition of restricted and unrestricted funds. The Basis for Conclusions for Section 36 explains the rationale for the development of a section on fund accounting. The Secretariat amended the relevant part of section 2 to include the title "Fund accounting" and to focus on the need to identify funds and their subsequent classification for presentation purposes.

BC2.44 TAG members deliberated how net assets is impacted by donations that cannot be converted to income. While these donations are initially recognised through revenue, their subsequent inclusion in net assets was discussed but not agreed. These types of donations, often described as endowment funds, have not been addressed in the first edition of INPAS.

Service potential

BC2.45 Although, not a priority area, following feedback from respondents to the consultation paper, INPAS includes service potential as a part of the recognition criteria in the relevant sections of INPAS. Service potential is not a concept explicitly recognised in the IASB Conceptual Framework. However, the IPSASB, Public Sector Conceptual Framework makes direct reference to it. Section 2 includes service potential in the definitions of the elements, where appropriate. This is because service potential is relevant for assets that an NPO holds not to generate cash flows, but rather for the services the asset can provide. The Secretariat also amended the measurement basis of value in use to include the concept of service potential.

BC2.46 Service potential is a more subjective concept than economic benefits, where resources are a measurement of cash inflows or a reduction of cash outflows. Concerns about the subjectivity of the term were raised in response to ED1. The Secretariat is of the view that service potential is a better expression of the resources embodied in assets used to provide services which do not generate economic returns. This is consistent with IPSAS 46 *Measurement* which includes the measurement of the operational capacity of an asset.

- BC2.47 Respondents also, raised concerns about the description of service potential and provided suggestions for alternative terms, including that it did not specifically refer to the provision of goods. The description of service potential in Section 2 explicitly refers to the provision of goods as well as services and the Secretariat concluded that no changes were required.
- BC2.48 The primary reason for holding assets and the type of assets used by an NPO need to be considered in their recognition and measurement. It is often the case that NPOs hold assets not to generate financial returns but to provide or support services. Where an NPO holds an asset for its service potential rather than its ability to generate cash flows, its recognition and measurement should provide information on the value of the asset's service potential to the NPO. Where an NPO holds an asset for its ability to generate cash flows then its recognition and measurement should provide information on its economic capacity. Implementation Guidance has been added to illustrate the concept of service potential.
- BC2.49 The proposal to separate 'service potential' as a distinct concept from 'economic benefit,' with 'economic benefit' only relating to cash inflows and outflows was not universally supported on the basis that 'economic benefit' encompasses more than just cash flows and would include service potential. The TAG discussed this issue and different views provided. However, on balance TAG members were of the view that INPAS should describe service potential as a separate concept such that it can be taken forward in the future development of INPAS and to make clear the relationship with the same or similar terms in other GAAPs.

Recognition and derecognition

- BC2.50 Feedback from the Consultation Paper was that users of general purpose financial reports do not associate the financial performance of NPOs with profit and loss, but there is general acceptance of the concept of a surplus or deficit. There was also feedback to request simplicity in the presentation of information. On this basis the INPAS Statement of Income and Expenses focuses on surplus and deficit and not comprehensive income as permitted in the *IFRS for SMEs Accounting Standard*. The Basis for Conclusions to Sections 3, 5 and 6 provides further explanation.
- BC2.51 As a consequence, the Secretariat has made amendments to address in which primary financial statements NPOs recognise transactions. These amendments ensure recognition of income and expenses that contribute to surplus and deficit in the Statement of Income and Expenses, and income and expenses that do not contribute to surplus and deficit are instead recognised in the Statement of Changes in Net Assets.

Presentation in General Purpose Financial Reports

- BC2.52 Presentation concepts and principles in both the *IFRS for SMEs Accounting Standard* and the IASB's Conceptual Framework focus primarily on the primary financial statements, whereas presentation in the IPSASB Conceptual Framework has a wider scope encompassing financial reports outside the core financial statements. The Secretariat used the IPSASB Conceptual Framework in developing additional presentation concepts and principles for INPAS.

Section 2 – Concepts and pervasive principles

The objective of non-profit organisations' general purpose financial reports

Users of general purpose financial reports

Are donors and other funders primary users of financial statements?

- IG2.1 Paragraph G2.7 confirms that donors (and other funders) are acting as primary users when they do not have rights to demand information tailored to meet their particular information needs. However, donors' (and other funders') needs are complex because in some instances they may only have access to generally available information and in other instances they may be able to require information to be tailored to meet their particular needs (special purpose financial reports). When donors (and other funders) are not requesting special purpose financial reports they are primary users.
- IG2.2 Any special purpose financial reports are outside the scope of INPAS. However, INPAS Practice Guide 1: *Supplementary Statements for donors* offers a standard format for an optional supplementary statement that can meet the financial accountability needs of grantors.

What information might be needed by resource providers and the public that benefit from the goods and services provided by NPOs or on the activities that they carry out?

- IG2.3 Resource providers and the public that benefit from the goods and services provided by the NPO or on the activities that they carry out need the financial and non-financial information in an NPO's general purpose financial report. This is to support accountability and decision making in the following areas:
- The financial activity of the NPO during the period. This will include information on how an NPO meets its missional purposes (including financial and service objectives). It will include information to assess whether the NPO has used resources in a way which maximises economy, efficiency, and effectiveness in the delivery of its activities. For example, information in the Statement of Income and Expenses and Statement of Changes in Net Assets will inform assessments of how an NPO has met its financial objectives and whether it has acquired its resources economically. The narrative report will also provide information on financial performance.
 - The sustainability of the NPO's activities over the long term and the demonstration of the achievement of its objectives. An NPO will need to provide users with information on its levels of funds and reserves. It will need to be able to demonstrate that it will be able to access long term funding sources and that these resources can meet current and future costs related to future activity.
 - Liquidity (ie resources available to meet current obligations) and solvency (ie resources to meet future obligations). The Statement of Cash Flows and associated notes will contain the relevant information.
 - The ability of the NPO to comply with the specifications set by government regulatory or other similar bodies that the NPO must satisfy in providing services and raising resources. The narrative report will be able to provide information to support this.

Qualitative characteristics of information in general purpose financial Reports

Fundamental qualitative characteristics

How might an NPO make decisions about materiality in the general purpose financial reports?

- IG2.4 NPOs need to assess the needs of their primary users. This assessment guides how NPOs report financial information and what information is important. It is therefore fundamental when considering materiality.
- IG2.5 When making materiality judgements, an NPO needs to consider the impact information could reasonably be expected to have on existing and potential primary users of its general purpose financial reports. Those primary users are:
- resource providers;
 - the public that benefit from the goods and services provided by NPOs; and
 - those acting as representatives of the interests of resource providers and the public that benefit from the goods and services provided by NPOs.
- These are users who cannot require NPOs to provide information directly to them and must rely on general purpose financial statements for much of the financial information they need. In addition to those primary users, other parties, such as the NPO's management, regulators and other members of the public, (ie those that do not benefit from the goods and services provided by the NPO) may be interested in financial information about the NPO and may find the financial statements useful. However, the financial statements are not primarily directed at these other parties.
- IG2.6 When assessing whether information is material to the financial statements and narrative report, an NPO applies judgement to decide whether the information could reasonably be expected to influence decisions that primary users make based on those financial statements. When applying such judgements, the NPO considers both its specific circumstances and what the information provided in the financial statements contributes to the decision making needs of primary users.
- IG2.7 The application of materiality is vital to support accountability and decision making. The definition of materiality at paragraph G2.23 focuses on information being material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make based on those reports.
- IG2.8 INPAS requirements only need to be met if their effect is material to the complete set of financial statements (including prior period information) and the narrative report. Judgements made on materiality are pervasive to general purpose financial reports. This means that all decisions (judgements) on information to be included in NPO general purpose financial reports, including recognition, measurement, presentation and disclosure, will be subject to materiality considerations. This includes what information can be aggregated or shown separately.
- IG2.9 The information needs of primary users are discussed in paragraphs IG2.2 – IG2.3 above. When making materiality judgements NPOs need to ensure that the needs of both existing and potential users are met. For example, where an NPO provides

medical services using both donated and non-donated assets (including hospitals and outreach centres to be able to serve the various local communities) it needs to consider the common information needs of its primary users. The NPO considers that the current users of the financial statements are the funders providing the donated assets. However, to decide what might be material information and to make the relevant materiality judgements the NPO must consider not only the current users of the financial statements, but also potential users. These potential users include:

- donors or funders that might contribute resources in the future;
- service users or other members of the community that rely on the medical services provided by the NPO; and
- individual members of a local government body that act on behalf those in receipt of the medical services.

- IG2.10 An NPO is only required to apply INPAS recognition and measurement requirements when the effect of applying them is material. An NPO might conclude that an item of information is material for various reasons. Those reasons include the item's nature (qualitative) or size (quantitative), or a combination of both, judged in relation to its circumstances. The NPO's assessment is thus both quantitative and qualitative.
- IG2.11 For example, **Section 17, Property, plant and equipment** requires that an NPO recognise an item of property, plant and equipment when it meets the criteria in paragraph **G17.4**. An NPO has assessed that its accounting policy to not capitalise some low value expenses on property, plant and equipment will not have a material effect on the current financial statements or on future financial statements. This is because information reflecting capitalised amounts and their depreciation that are below this low value threshold could not reasonably be expected to influence decisions made by the primary users of the NPO's financial statements. The NPO therefore decides to establish an accounting policy of only capitalising items of property, plant and equipment above a certain threshold.
- IG2.12 Materiality can also affect how information is presented and disclosed. For example, an NPO might carry its property, plant and equipment at historical cost in the Statement of Financial Position. However, it may have a single investment property that it cannot reliably measure at fair value, and which is therefore measured at historical cost less accumulated depreciation and impairment. Paragraph **G4.2** requires investment properties held at historical cost less accumulated depreciation to be presented as a separate line item in the statement of financial position.
- IG2.13 However, if the NPO determines that the carrying value of the single investment property is not material it might decide to present it in the property, plant and equipment line item. The NPO may also take the decision to report the item as a separate column in the reconciliation of the property, plant and equipment note showing separately aggregations of items of property, plant and equipment and the investment property.
- IG2.14 The example of the application of materiality in **IG2.13–IG2.14** above is based on an assessment of quantitative materiality and assumes that there are no relevant qualitative factors.

What factors should an NPO consider to assess materiality?

- IG2.15 Paragraph G3.17 requires that an NPO assess whether information, either individually or in combination with other information, is material in the context of its financial statements when these are taken as a whole. This means that while information is not judged to be material on its own, it might be material when considered in combination with other information in the complete set of financial statements.
- IG2.16 An NPO will normally assess whether financial information is quantitatively material by considering the size of the impact of the transaction, other event or condition. This is considered against measures of its financial position (eg net assets), financial performance (eg income, expenses and/or surplus or deficit) and cash flows.
- IG2.17 The assessment includes not only the size of the impact of a transaction that it recognises in its primary financial statements but also takes account of any unrecognised items that could ultimately affect primary users' overall perception of the NPO's financial position, financial performance and cash flows (eg contingent liabilities or contingent assets). The NPO needs to determine if the impact is of such a size that information about the transaction, other event or condition could reasonably be expected to influence its primary users' decisions about the NPO including the provision of resources to it. So this might, for example, be decisions about when to recognise an item or income or expense in the financial statements (timing) or whether an item is so material that it should be presented on the face of the Statement of Income and Expenses or otherwise included in the relevant disclosures.
- IG2.18 Identifying what measures to use for the quantitative assessment is a matter of judgement. Measures may be a specified amount (threshold amount), a rate (percentage) relative to amounts in the primary financial statements or some other level and these are often used as a tool in making materiality judgements. The measure selected will need to be appropriate for the transaction, event or condition.
- IG2.19 An assessment about materiality is often made with reference to the overall level of income. However, as income can fluctuate between years, it may be more appropriate to use expenses as a reference point. Judgements about materiality depend on which measures are of significant interest to the primary users of the NPO's financial statements. Other example measures might be:
- overall revenues for grants and donations;
 - total expenses;
 - the NPO's financial surplus or deficit;
 - total funds in net assets;
 - total non-current assets;
 - financial position ratios; and
 - cash flow measures.
- IG2.20 Materiality assessments also require analysis of NPO specific and external qualitative factors. Qualitative factors related to an NPO's transactions, other events or conditions include, but are not limited to:
- Local and national interest, including political or community interest, in a transaction, event or condition.
 - Receipt of a donation from an individual or organisation with conflicting objectives to those of the NPO.
 - Related party involvement in an NPO.
 - Uncommon or non-standard features in an NPO's operations.

- Unexpected variations or unexpected changes in trends.

- IG2.21 An NPO could identify an item of information as material based on one or more materiality factors. Generally, the more factors that apply to an item, or the more significant those factors are, the more likely it is that the item is material. These factors may need to be considered individually or as a combination of factors.
- IG2.22 External qualitative factors relate to the context in which an NPO operates. This might be related to transactions, events or conditions that if present are more likely to influence primary users' decisions. They might include but are not limited to the economic or regulatory environment, an NPO's location, the sector an NPO operates in, regulatory issues or the particular concern that many NPOs and their primary users have for environmental issues.
- IG2.23 The presence of qualitative factors generally lowers the thresholds for the quantitative assessment. The more significant the qualitative factors, the lower those quantitative thresholds will be.

How might materiality judgements affect presentation of information in general purpose financial reports?

- IG2.24 An NPO will need to use materiality judgements to present information in the financial statements in a clear and understandable way, this might be to:
- aggregate or disaggregate information;
 - emphasise material matters or items of information;
 - describe transactions as simply as possible without omitting material information or adding to the length of the general purpose financial report;
 - provide information in a way that maximises, to the extent possible, comparability among NPOs and across reporting periods;
 - highlight relationships with different pieces of information across the general purpose financial report;
 - present information appropriately for primary users, for example, in a narrative or tabular format;
 - avoid or minimise duplication in different parts of the general purpose financial report.
- IG2.25 An NPO will need to consider the overall perspective of its financial position, financial performance and cash flows, along with its non-financial information. It also needs to consider the relationships between different items of information and aggregations of information which might lead to an item being assessed as material. NPOs must also consider whether the NPO's financial position, financial performance and cash flows, along with its non-financial information, are presented in a fair and understandable way to avoid obscuring material information.

How will materiality interact with regulatory requirements?

- IG2.26 For an NPO to confirm compliance with INPAS it must comply with the requirements of its sections including those related to materiality. An NPO cannot provide less information than required by INPAS and confirm compliance even if local laws and regulations permit otherwise. Conversely, local laws and regulations may specify requirements which will require information to be provided even if this does not meet

an NPO's quantitative or qualitative measures of materiality. This might, for example, include information to be reported on remuneration. In such cases providing information in accordance with the regulatory requirements is permitted by INPAS though NPOs should avoid obscuring material information in the financial statements.

Undue cost and effort

How does an NPO determine when it can or should use the undue cost or effort exemption?

- IG2.27 An undue cost or effort exemption is available to reporting NPOs for certain requirements in INPAS. As explained in G2.39–G2.40 this will depend on:
- a) the NPO's specific circumstances;
 - b) management's judgement on the costs and benefits from applying that requirement; and
 - c) the information available at the time of the assessment.
- IG2.28 It is important that NPOs do not treat the undue cost or effort exemptions as accounting policy choices. They are not. An accounting policy choice is appropriate when INPAS explicitly includes options for the accounting treatment for an item or transaction, such as a cost measurement basis for the valuation of certain assets. An undue cost or effort exemption would be relevant specifically for those situations where management has selected the fair value measurement basis for the valuation of those assets but is unable to determine a fair value without undue cost or effort and hence uses the exemption and values them using cost as a measurement basis.

What factors might lead to undue costs or undue effort?

- IG2.29 An NPO's specific circumstances will vary and this will be a driver of the cost and level of effort required. It is not possible to reflect all situations, but factors may include:
- the relative costs of producing the information in relation to the benefit to users – the cost of producing the information would be expected to be material to the NPO's income and expenses;
 - the practicalities in obtaining the information needed;
 - the expectation that, if the information relates to the first occurrence of the type of transaction, whether the initial cost from its recognition and measurement, although initially significant, will be lower on an ongoing basis;
 - consideration of the asset's or liability's significance in relation to the NPO's operations when applying the undue cost or effort provisions; and
 - consideration of the asset's or liability's significance in relation to an NPO's assets when applying the undue cost or effort provisions.
- IG2.30 In determining the NPO's specific circumstances, an NPO should consider these factors, alongside other relevant context, individually and collectively. As an example, there may be no suitably qualified valuers in the jurisdiction in which an NPO operates an asset that requires measurement. A valuer would need to physically inspect the asset to provide a valuation, and therefore a valuer from another jurisdiction would be needed. This may result in an 'undue cost or effort', because of a language barrier or the cost of travel and/or subsistence. An NPO also might need to consider the specific circumstances of the absence of a valuation professional in the context of the other factors. It may or may not in itself be sufficient to support an exemption.

How should an NPO measure the impact of the benefits to users in the context of undue cost or effort?

- IG2.31 Management's judgement on the impact on the benefits that users would gain from applying that requirement requires consideration of:
- a) how the economic resource allocation and other decisions of those that are expected to use the financial reports could be affected by not having that information; and
 - b) whether there is undue cost or effort involved in the incremental cost or additional effort that would substantially exceed the benefits to users of the financial reports.
- IG2.32 These judgements are concerned with the users of the financial information. An NPO needs to consider the benefits that users of general purpose financial reports might have had if the information had been available and therefore the impact of it not being available. Management will need to consider and be able to explain factors such as:
- the reliance that users might have placed on the affected information;
 - the extent to which this information is routinely provided by other NPOs in the locality or in the NPO's field of activity;
 - the importance of the information to the financial objectives of the NPO; and
 - the loss of the information to the understanding of the NPO's financial resilience.

How might management decide to exercise the judgement for the undue cost or effort exemption?

- IG2.33 Management must not use the undue cost or effort exemptions to avoid providing information that an NPO would prefer not to disclose. The exercise of judgement is fundamental to decisions made. As required in G2.41, management must be able to explain its rationale for exercising the exemption through disclosures in the notes to the accounts. The explanation should identify:
- the key factors that have led to management's decision;
 - the weight applied to each of these factors;
 - how the balance of the factors had led to the conclusion; and
 - cover both the impact on costs and effort as well as the impact on the loss of information.
- IG2.34 An NPO will need to assess its decisions on the use of undue cost or effort exemptions if the latest information at the reporting date changes. This may result in the removal of the exemption or change the reasons for its use, which an NPO should report. As is noted in paragraph G2.40 if the undue cost or effort exemption applies after initial recognition to a subsequent measurement of an item, for example, where the fair value of investment properties cannot be measured reliably without undue cost or effort, a new assessment of undue cost or effort should be made at that subsequent date based on information available at that date.

General purpose financial reports and the reporting NPO

The reporting NPO

What does an NPO need to consider when determining its reporting boundary?

- IG2.35 Paragraphs G2.48–G2.51 set out the requirements relating to the identification of a reporting NPO, including the need to prepare general purpose financial reports as if it were one economic entity or other complete set of activities.
- IG2.36 An economic entity or other complete set of activities is likely to exist where there is an identifiable and integrated set of activities and assets operated to raise or manage funds and resources for the NPO. The NPO uses these collective resources to provide services and goods for the benefit of the public.
- IG2.37 There may be circumstances when it is difficult to identify the reporting NPO. This might be when:
- the organisational structures are complex or hard to define; or
 - the potential reporting entity might be a part of a legal entity; or
 - the potential reporting entity may be a combination of two or more legal entities.
- Complexities may also come from the existence of branches. See paragraphs IG2.45–IG.46 for more guidance on the identification of branches.
- IG2.38 When difficulties remain in identifying the reporting NPO, NPOs will also need to apply paragraph G2.53, which requires the determination of the boundary of the reporting NPO by examining the existence of users and their information needs. These users of the reporting NPO's general purpose financial reports will include:
- the public, to whom the NPO provides services and goods;
 - resource providers to the NPO; and
 - those acting in their capacity as representatives of the interests of resource providers and the public that benefit from the goods and services provided by NPOs.
- IG2.39 INPAS expects users of the general purpose financial reports to be able to take economic or other decisions based on the information provided in these reports. The reports should also provide transparency over how an NPO has demonstrated accountability in relation to a range of obligations. In many cases, the range of users who are dependent on the general purpose financial reports for accountability purposes, making decisions or allocating resources will be obvious. However, to determine who the users might be and their need for financial reporting, it may be necessary to consider such factors as:
- whether management is acting on behalf of others providing resources;
 - impacts of the NPO's activity on the welfare of external parties; and
 - the financial characteristics of the NPO, including its size.
- IG2.40 In considering size, NPOs should take account of all relevant information, including the level of any indebtedness, the number of transactions, the amount of financial and other resources it receives, and the number of members of the public who benefit from the services and goods it provides. The larger the size of the NPO, the more likely that users will exist who use the financial or other reported information for decision-making and accountability purposes.
- IG2.41 When assessing the boundary of a reporting NPO based on the existence and information needs of users, it is essential that the boundary:
- does not contain an arbitrary set of economic activities (or other set of activities related to its purposes)

- that is incomplete (ie if the financial information provided would be incomplete and lack neutrality, this would not meet the requirements for faithful representation of transactions); and
- results in information for the users of the general purpose financial reports that is neutral, in accordance with the requirements for faithful representation (ie the information presents what it purports to represent).

What does the reporting NPO need to consider when it operates through a system of branches?

- IG2.42 NPOs may operate through a system of branches, which are administrative arrangements. This is where the arrangement of the NPO's operating structure is according to function, location, or other factor to facilitate its administration. These branches may include supporters' groups, members' groups, or offices in various locations, and they may operate nationally or internationally. When the branch is a part of a reporting NPO (for example, an internal subdivision of a reporting entity), the general purpose financial reports of the reporting NPO should include the activities of the branch. INPAS describes such internal subdivisions as internal branches.
- IG2.43 A branch may produce a separate general purpose financial report because of legal or other regulatory requirements. However, INPAS requires that the NPO still considers its relationship, if any, with that branch or other reporting NPO entity for financial reporting purposes.

How might a reporting NPO identify internal branches?

- IG2.44 An NPO may consider the following factors to assist in its decisions about whether an operational structure is an internal branch of an NPO and not a separate reporting entity. The operational structure:
- is not a separate legal structure;
 - is not required to provide separate general purpose financial reports;
 - uses the name of the reporting NPO in its title, its letterheads, on its website or as a part of its publicity;
 - raises funds solely for the reporting NPO;
 - presents itself to the public as a local or other form of representative of the reporting NPO; and/or
 - receives financial and administrative support, instruction, and advice from the reporting NPO.
- Note the list above is not exhaustive.
- IG2.45 Consideration of these factors will require judgement. Displaying just one of the factors may not mean that an organisation meets the definition of a branch, but in combination with another might lead the reporting NPO to decide that it is an internal branch.

How should assets, liabilities, net assets, income and expenses of branches be recognised?

- IG2.46 There might be occasions when an internal branch produces separate regulatory general purpose financial reports but may still be an internal branch. In such circumstances, the NPO must recognise all the income, expenses, assets, and liabilities in its financial statements. This is unlikely to be regularly the case but might happen where, for example, an international NPO has internal branches in separate

jurisdictions and where one or more of those jurisdictions requires that the organisation (which is an internal branch of the international NPO) produce separate general purpose financial reports.

- IG2.47 An NPO must record all transactions of an internal branch as gross within its general purpose financial reports and not net them off against other transactions within its own separate general purpose financial report unless another Section in this Standard permits such netting off. Where a reporting NPO consists of multiple branches any intra-branch transactions should be eliminated within the financial statements of the reporting NPO.
- IG2.48 Branches may hold separate bank accounts and/or produce financial statements for their own purposes. However, the general purpose financial reports of the reporting NPO must include the transactions of an internal branch or branches including its assets, liabilities, net assets, and restricted and unrestricted funds in net assets and income and expenses.
- IG2.49 For example, the reporting NPO must recognise in its financial statements all its funds raised by internal branches as income where they meet revenue recognition criteria in [Section 23 Revenue](#).

How does an NPO determine whether a subscription or fee-based structure is a reporting NPO or another form of reporting structure?

- IG2.50 NPOs may operate under a subscription or fee-based structure. In such circumstances the NPO may pay a subscription or a fee to a national or international NPO as a means to fund that NPO. A national or international NPO will set the parameters under which the subscribing or fee paying NPOs operate. The subscribing or fee-paying organisations that operate under such frameworks might take the form of the three structures discussed in the table below:

Table 1: Typical forms of operating structures that are subscription or fee based

	Type of organisation	Accounting treatment
1	Part of the national or international organisation (this may or may not be operating as an internal branch)	INPAS requires that the financial and other transactions are included in the general purpose financial reports of the national or international NPO.
2	A separate legal entity or other incorporated structure which has a relationship with the national or international NPO	INPAS requires that the NPO ascertain the financial reporting relationship, if any, with that organisation in accordance with Sections 2 and 9.
3	Separate legal entities or other incorporated structure where there is no financial reporting relationship with the NPO	INPAS requires these organisations to produce general purpose financial reports as a separate reporting NPO (if meeting the definition of a reporting NPO). Where relevant the NPOs should follow national financial reporting requirements.

How does an NPO determine that organisations established as a separate legal entity to manage the financial burden or risk of the activities of the NPO, or purely for fundraising activities, are reporting NPOs or another form of structure?

- IG2.51 NPOs may be established as separate legal entities to:
- undertake specific activities;
 - manage the risk of loss; or
 - for the sole purpose of raising funds, for example to provide financial support to a hospital.
- IG2.52 The NPO that creates these separate legal entities will need to establish its financial reporting relationship, if any, with these separate legal entities (including any reporting NPOs) based on the provisions in Section 2 on the identification of a reporting NPO and the definition of control in Section 9 of INPAS.

How does an NPO determine that organisations using affiliated structures are a reporting NPO or another form of structure?

- IG2.53 Organisations may operate as 'affiliated' structures. These organisations may include both individuals and/or other organisations including NPOs as members. These members may pay a fee or subscription for access to services or other membership benefits. When these relationships are more akin to a customer-supplier relationship, the NPO has not established a financial reporting relationship with its members.

When might an NPO need to consider service potential?

- IG2.54 Assets held by NPOs that embody service potential may be held, for example, for community purposes, or for medical or recreational purposes and are used to provide or support services for the public that use them. Such services may be for collective or individual consumption and payment for those services might be at cost or for a nominal charge. Services may be provided in areas or activities in which market competition is limited or non-existent or alternatively may be provided on an economic basis or not.

Illustrative examples – Section 2 – Reporting NPO

The following illustrations assume that the relevant transactions are material.

Example 1. Separate legal entities with a relationship with an NPO

Background

NPO A promotes dramatic arts throughout a jurisdiction. A subdivision operates one of the activities, the “For Everyone Theatre”, which develops theatrical plays that promote diversity. The “For Everyone Theatre” has a separate bank account to manage the income from the theatre sales.

NPO A establishes six NPO entities which tour the plays developed by “For Everyone Theatre” across six of the regions of the nation. It establishes the governing bodies for each of the entities, where it appoints the majority of the membership of each board. There is a standard constitution to operate within a set of parameters. Each of these entities pays 50% of its ticket sales to NPO A when they reach a certain agreed level. NPO A uses this fee to develop the plays for the following year’s programme of the “For Everyone Theatre”. Other NPO theatre groups can also pay a fee for the plays and may use the national logo for the diversity-based plays, though they must agree to perform the plays as written.

Analysis

NPO A includes the “For Everyone Theatre” transactions, including the financial assets in the bank account, in its financial statements.

The six NPO theatre entities are separate legal entities and NPO A needs to establish the financial reporting relationship with those companies. As NPO A establishes the constitution, appoints the majority of the voting members of the governing body, and benefits from the relevant activities (both receipt of the fees and the promotion of the relevant activities established under the constitution), NPO A controls the six NPO theatre entities.

Other NPO theatre groups that were not set up by NPO A are separate entities (or parts of separate entities). Entity A has no power in relation to their governing bodies or the operation of these theatre groups. There is no direct financial reporting relationship with Entity A. These theatre groups will produce their own financial statements under the provisions of INPAS or other GAAP under which they might operate.

Example 2. Entity established by an NPO

Background

NPO B, a hospital, decided to have a more focused approach to fundraising, it therefore set up a separate NPO Entity (NPO C) solely to raise funds for the hospital. This allows NPO C to focus on attracting legacies from individuals in the locality and invest the resources to maximise returns (provided this was effectively risk managed and in accordance with the charitable purposes of NPO C).

NPO B establishes NPO C using the name of the hospital and establishes its purposes such that fundraising is solely for use by the hospital. NPO C pays a regular dividend to the hospital to fund services.

Analysis

Based on the facts and circumstances outlined above and because NPO B:

- has established the charitable purposes of NPO C;
 - determines the use of those resources; and
 - has created a mechanism where it has power over the relevant activities of NPO C to benefit from these relevant activities,
- as a result, NPO B controls NPO C.

NPO B would include NPO C into its consolidated financial statements as a controlled entity.

Example 3. Affiliated organisations

Background

A tennis association, NPO D, improves the fitness of a nation through the medium of tennis. There are twenty separate legal entities, tennis clubs that pay a subscription to the association and receive non-mandatory advice and guidance on how to run a tennis club to improve the fitness in a local area and on issues such as inclusivity and outreach. Individuals not able to sign up to a club can become members of the association for a small fee. NPO D provides regular videos to improve their skills and the individuals can update a chart when they have mastered a particular skill.

Analysis

The twenty separate legal entities have customer-supplier relationships with the umbrella organisation, NPO D.

While they receive advice and guidance from NPO D, NPO D does not require them to follow that advice and guidance. NPO D does not have power over the relevant activities or funds of these separate legal entities.

NPO D may be a reporting NPO, as a separate legal entity. The twenty tennis clubs are also separate legal entities. However, as their relationship with NPO D only concerns the provision of services, and NPO D does not have power to control their activities or funds, they will produce their own financial statements. NPO D will not consolidate them into its financial statements.

Example 4. Internal branches

Background

NPO E supports educational needs across a nation. It has six internal branches, which are all separate unincorporated organisations. NPO E establishes the following organisations:

- Organisation A raises funds for NPO E across the nation.
- Organisations B, C and D distribute resources effectively across communities identifying where need for services is greatest. They have all established separate bank accounts and produce informal quarterly financial accounts. Organisation D is always late with its monthly returns and disputes the need to produce them. Its bank account was set up in the name of the chief finance officer.

- Organisation E to raise awareness of specific educational needs.
- Organisation F provides administrative support for the effective operation of organisations A to E and to provide advice and guidance on operational and financial issues.

NPO E established all six organisations to follow its constitution. They use the same website, letter heads and the title of NPO E.

Analysis

Despite the separate bank accounts, all six organisations are internal branches to the national NPO E. This is because the organisations meet four of the factors that might indicate they are branches ie they:

- are not separately incorporated;
- do not have autonomous governing bodies;
- follow the financial reporting and other operational requirements of the main NPO; and
- use the same website and letterheads of the national NPO.

NPO E should recognise the funds raised by Organisation A as its income. Even though Organisation D challenges the structure and has established the bank account in the name of its chief finance officer, the funds are used to benefit the recipients of the educational services of NPO E. NPO E therefore recognises the transactions of organisation D in its financial statements as a reporting NPO