Chapter I

1. Preface

The purpose of this standard is to guide not for profit organizations (NPOs) to prepare a general-purpose financial statements.

The objective in setting up *Nepal Accounting Standard for Not for Profit Organization (NAS for NPO)* is to assist those who are responsible for the preparation of the financial statements, to improve the quality of financial reporting thereby providing adequate information to the users of the financial statements. The intention is also to reduce the diversity that exists among NPOs in accounting practice and presentation. It is recommended that all NPOs follow this Standard in order that their financial statements provide a true and fair view of the state of affairs of their organizations. It provides the basis for the preparation of accrual based financial statements to give a true and fair view.

The purpose of preparation of the financial statements in accordance with this standard is to report it to the external donors, members, creditors and other entities that provide resources to non-profit organizations. NPOs shall have to comply only those Standards, which are applicable with them.

If a NPO applies this Standard, the basis of preparation, notes and audit report can refer to conformity with the *Nepal Accounting Standards for Not for Profit Organization (NAS for NPOs).*

2. Accounting Framework for Financial Reporting

2.1 Users and their information needs

Financial statements of NPOs are used for different purposes and their information requirements vary considerably. Unlike in the corporate sector, NPOs have neither owners nor investors. The most common groups of users of NPO financial statements are the resource providers or contributors, funding agencies, beneficiaries, suppliers/creditors, employees and the Government authorities. Some NPOs have members who represent an essential group of users. Others might have partner organizations with whom they co-operate, and who will be important users of the financial statements.

2.2 Qualitative characteristics of useful financial information

If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.

Fundamental qualitative characteristics

The fundamental qualitative characteristics are *relevance, materiality* and *faithful representation*.

Relevance

Relevant financial information is capable of making a difference in the decisions made by users. Information may be capable of making a difference in a decision even if some

users choose not to take advantage of it or are already aware of it from other sources. Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both.

Financial information has predictive value if it can be used as an input to processes employed by users to predict future outcomes. Financial information need not be a prediction or forecast to have predictive value. Financial information with predictive value is employed by users in making their own predictions.

Financial information has confirmatory value if it provides feedback about (confirms or changes) previous evaluations.

The predictive value and confirmatory value of financial information are interrelated. Information that has predictive value often also has confirmatory value. For example, revenue information for the current year, which can be used as the basis for predicting revenues in future years, can also be compared with revenue predictions for the current year that was made in past years. The results of those comparisons can help a user to correct and improve the processes that were used to make those previous predictions.

Materiality

Information is material if omission or misstatement could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an 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 entity's financial report. Consequently, a uniform quantitative threshold for materiality cannot be specified or predetermined what could be material in a particular situation.

Faithful representation

Financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the phenomena that it purports to represent. To be a perfectly faithful representation, a depiction would have three characteristics. It would be complete, neutral and free from error. Of course, perfection is seldom, if ever, achievable. The objective is to maximize those qualities to the extent possible.

A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations. For example, a complete depiction of a group of assets would include, at a minimum, a description of the nature of the assets in the group, a numerical depiction of all of the assets in the group, and a description of what the numerical depiction represents (for example, original cost, adjusted cost or fair value). For some items, a complete depiction may also entail explanations of significant facts about the quality and nature of the items, factors and circumstances that might affect their quality and nature, and the process used to determine the numerical depiction.

A neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasized, de-emphasized or otherwise manipulated to increase the probability that financial information will be received favorably or unfavorably by users. Neutral information does not mean information with

no purpose or no influence on behavior. On the contrary, relevant financial information is, by definition, capable of making a difference in users' decisions.

Faithful representation does not mean accurate in all respects. Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate.

A faithful representation, by itself, does not necessarily result in useful information. For example, a reporting entity may receive property, plant and equipment through a government grant. Obviously, reporting that an entity acquired an asset at no cost would faithfully represent its cost, but that information would probably not be very useful. A slightly more suitable example is an estimate of the amount by which an asset's carrying amount should be adjusted to reflect impairment in the asset's value. That estimate can be a faithful representation if the reporting entity has properly applied an appropriate process, properly described the estimate and explained any uncertainties that significantly affect the estimate. However, if the level of uncertainty in such an estimate is sufficiently large, that estimate will not be particularly useful. In other words, the relevance of the asset being faithfully represented is questionable. If there is no alternative representation that is more faithful, that estimate may provide the best available information.

Applying the fundamental qualitative characteristics

Information must be both relevant and faithfully represented if it is to be useful. Neither a faithful representation of an irrelevant phenomenon nor an unfaithful representation of a relevant phenomenon helps users make good decisions.

The most efficient and effective process for applying the fundamental qualitative characteristics would usually be as follows (subject to the effects of enhancing characteristics and the cost constraint, which are not considered in this example). First, identify an economic phenomenon that has the potential to be useful to users of the reporting entity's financial information. Second, identify the type of information about that phenomenon that would be most relevant if it is available and can be faithfully represented. Third, determine whether that information is available and can be faithfully represented. If so, the process of satisfying the fundamental qualitative characteristics ends at that point. If not, the process is repeated with the next most relevant type of information.

Enhancing qualitative characteristics

Comparability, *verifiability*, *timeliness* and *understandability* are qualitative characteristics that enhance the usefulness of information that is relevant and faithfully represented.

Comparability

Users' decisions involve choosing between alternatives, for example, selling or holding an investment, or investing in one reporting entity or another. Consequently, information

about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date.

Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items. Unlike the other qualitative characteristics, comparability does not relate to a single item. A comparison requires at least two items.

Consistency, although related to comparability, is not the same. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities. Comparability is the goal; consistency helps to achieve that goal.

Comparability is not uniformity. For information to be comparable, like things must look alike and different things must look different. Comparability of financial information is not enhanced by making unlike things look alike any more than it is enhanced by making like things look different.

Some degree of comparability is likely to be attained by satisfying the fundamental qualitative characteristics. A faithful representation of a relevant economic phenomenon should naturally possess some degree of comparability with a faithful representation of a similar relevant economic phenomenon by another reporting entity.

Although a single economic phenomenon can be faithfully represented in multiple ways, permitting alternative accounting methods for the same economic phenomenon diminishes comparability.

Verifiability

Verifiability helps assure users that information faithfully represents the economic phenomena it purports to represent. Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Quantified information need not be a single point estimate to be verifiable. A range of possible amounts and the related probabilities can also be verified.

Verification can be direct or indirect. Direct verification means verifying an amount or other representation through direct observation, for example, by counting cash. Indirect verification means checking the inputs to a model, formula or other technique and recalculating the outputs using the same methodology. An example is verifying the carrying amount of inventory by checking the inputs (quantities and costs) and recalculating the ending inventory using the same cost flow assumption (for example, using the first-in, first out method).

It may not be possible to verify some explanations and forward-looking financial information until a future period, if at all. To help users decide whether they want to use that information, it would normally be necessary to disclose the underlying assumptions, the methods of compiling the information and other factors and circumstances that support the information.

Timeliness

Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is 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 may need to identify and assess trends.

Understandability

Classifying, characterizing and presenting information clearly and concisely make it *understandable*.

Some phenomena are inherently complex and cannot be made easy to understand. Excluding information about those phenomena from financial reports might make the information in those financial reports easier to understand. However, those reports would be incomplete and therefore potentially misleading.

Financial reports are prepared for users who have a reasonable knowledge of operating and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

2.3 The cost constraint on useful financial reporting

Cost is a pervasive constraint on the information that can be provided by financial reporting. Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information. There are several types of costs and benefits to consider.

Providers of financial information expend most of the effort involved in collecting, processing, verifying and disseminating financial information, but users ultimately bear those costs in the form of reduced returns. Users of financial information also incur costs of analyzing and interpreting the information provided. If needed information is not provided, users incur additional costs to obtain that information elsewhere or to estimate it. Reporting financial information that is relevant and faithfully represents what it purports to represent helps users to make decisions with more confidence. This results in more efficient utilisation of grant and all stakeholders also receive benefits by making more informed decisions. However, it is not possible for general purpose financial reports to provide all the information that every user finds relevant.

In applying the cost constraint, the Accounting Standards Board of Nepal (ASB Nepal) assesses whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information. When applying the cost constraint in developing a proposed financial reporting standard, ASB Nepal seeks information from providers of financial information, users, auditors, academics and others about the expected nature and quantity of the benefits and costs of that standard. In most situations, assessments are based on a combination of quantitative and qualitative information.

Because of the inherent subjectivity, different individuals' assessments of the costs and benefits of reporting particular items of financial information will vary. Therefore, ASB Nepal seeks to consider costs and benefits in relation to financial reporting generally, and

not just in relation to individual reporting entities. That does not mean that assessments of costs and benefits always justify the same reporting requirements for all entities. Differences may be appropriate because of different sizes of entities, different ways of raising capital (publicly or privately), different users' needs or other factors.

2.4 Underlying assumption

Going concern

The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis and, if so, the basis used should be disclosed.

3. Applicability

This standard is for not for profit organization, regardless of whether or not legal personality applies to all forms of non-profit organizations for the purpose of the benefit of society as a whole.

4. Reporting entity

According to this criterion the financial statements will be prepared to the entire non-profit organization as a single reporting entity.

5. Double-entry bookkeeping and accrual

According to the criterion, this standard is based on the concept of the double entry accounting and accrual accounting.

6. Financial statements

The financial statements include to each of the following documents:

a) Statement of financial position;

b) Statement of income and expenditure;

c) Statement of change in reserve;

d) Cash flow statement; and

e) Statement of accounting policies and notes to financial statements.

As part of the explanatory notes to the financial statements, NPOs may also include supplementary schedules and information based on or derived from, and expected to be read with, such statements. Financial statements would not, however, normally include such items as reports by the governing body/management, statements by the chairman, discussion and analysis by management and similar items that may be included in a financial or annual report of a corporate entity, unless required by the relevant Donor Agreements.

In NPOs it is required to separate the activities of externally funded projects from the 'core' activity of managing the organization. Each funded project should have a neutral effect on the Statement of Income & Expenditure (i.e. neither surplus nor deficit) and the total income and costs of these projects may fluctuate significantly from year to year. Donors are interested to see the sources and level of income generated for funding the core management of the organization, as well as the types of expenditure that are covered, as this gives a guide as to the sustainability of the organization and helps to justify the level of administration charges made against projects. Therefore, the NPOs shall prepare the following two statements for externally funded projects as *Project Level Reporting* as required by the Agreement where the above mentioned first five statements may or may not be relevant.

f. Fund accountability statement

g. Statement of budget variance (Budgeted Vs Actual Expenditure Report)

7. Determination of accounting policies

This Standard does not specify recognition and measurement of specific transactions or events in the reference. Presentation of Financial Statements and determination of the accounting policies shall be made in accordance with this standard.

8. Accounting policies, errors and accounting estimates

a) Accounting policies and accounting estimates adopted for the preparation of the financial statements are equally applicable to accounting treatment of similar types of events and transactions.

b) Changes in accounting policies refer to change in accounting policy that was applied in the preparation of financial statements. Changes in accounting policies in this case include such changes like cost formula for inventory.

c) Requirement to change in accounting standards or policies: Change in accounting policy shall be done to enhance credibility of the Financial Statements for the purpose of providing more relevant information.

d) Changes in accounting estimates: Changes in the environment, acquisition of new information, accumulation of experience etc. call for the changes on the method of accounting estimates. In this case, the accounting estimates include estimates of loan, judgment and assessment of the obsolescence of inventories, estimation of liabilities, the future economic depreciation, expected significant changes in the consumption patterns, benefits embodied in the asset that affect the estimation of useful lives and residual values of depreciable assets.

e) Changes in accounting policies applied retrospectively, and the comparative financial statements is restated to reflect the modifications in accordance with the retrospective application.

f) Change of accounting estimates is processed prospectively accounting reflects the effect of the period after the change in estimates.

g) Correction for omission or misstatement: This refers to the modifications to the accounting omission or misstatement discovered in the current period, including the financial statements of the previous fiscal year. This should be done retrospectively.

9. Classification of financial statements

Important items are identified separately to best represent the content in the body of the financial statements. The important criterion, relating to the financial statements applies to the financial statements, the text and comments may differ.

10. Preparation of comparative financial statements

The format of the financial statements shall compare all the material information of the financial statements in order to increase the period comparability of financial statements. If the qualitative information in the financial statements is relevant to the understanding of the financial statements, comparative information shall be listed in the comments.