Exposure Draft

Guidance Note on

Financial Statements of

Non-Corporate Entities

(Comments to be received by March 8, 2023)

The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

New Delhi

Comments:

Chapter: 1 Introduction

Objective and Scope of Guidance Note Non-Corporate Entities – A wide spectrum of entities

This part may include the following:

1. Non corporate entities are three types:
    1) Public sector entities
    2) Private sector SMEs
    3) Not-for-profit entities

2. In the case of Non-profit entities, despite the widespread acceptance that charities should discharge accountability, there is limited knowledge of the relative importance of different stakeholder groups and whether the information currently being disclosed meets their needs.

3. While donors are viewed as the key stakeholder to whom a charity should be accountable, the relevance of the information commonly disclosed in formal charity communications is questionable. This is viewed as significant in terms of small dependent donors, although less critical in the case of non-dependent large donors who have power to demand individualised information. However, although all donors do not particularly engage with these formal communications, they are viewed by them as having significance and their production and publication serves as an important legitimising tool in the sector.

4. The following are types and resourcing of charities:
(i) Classic (by donations),
(ii) Service Providers (by funders of goods and services including government and donations),
(iii) Members organisations (by membership),
(iv) Infrastructure providers (by rental) and T
(v) Trust/Grantor (by investments).

5. The above category of Non-profit entities need differentiated regulation according to the main source of revenues and the spread of public contributors.

6. The growth in the size and influence of the sector has led to increased visibility and public scrutiny by diverse stakeholders including government oversight agencies, private donors and foundations, clients, the media and the public at large.

7. Audit quality affects donor decisions in the market for contributions. By and large, donors favour charities that use high quality auditors and the propensity to donate varies directly with audit quality. Infact, charities benefit simply from engaging a higher quality auditor. From an information perspective, donors are more sensitive to changes in reported accounting information verified by a high-quality auditor. Thus, a charity’s reputation and

the choice of auditor are substitute mechanisms for signalling the credibility of financial information to donors.
8. Donors integrate non-financial information into their decisions as their actual donations are significantly correlated with such information. While individual donors acquire financial efficiency measures, including the program expense ratio and fundraising expense ratio, they do not seem to integrate such information into their decisions as their actual donations are not significantly correlated with the efficiency information. A logistic regression provides evidence that some donors use financial accounting information when making a donation decision. Donors who had previously contributed to the organizations are more likely to give when financial efficiency measures are provided to them directly.

9. Therefore, the financial statements to report not only the financial data in order to meet the information needs of government regulators but also to meet the interest of the contributors. Donors are much more likely to acquire non-financial information, and also integrate non-financial information into their decisions, as their actual donations are significantly correlated with such information. While they acquire financial efficiency measures, such as expense ratios, they may not integrate such information into their decisions. What matters for policy efficacy is not how much information is provided but of what type.

10. The users of both Public and Private entities of NPEs have similar perceptions regarding the usefulness of financial statements, with the income statement and balance sheet rated as the most useful components. Furthermore, both types of users, especially private users, perceive financial statements as the most important information source for decision making. whereas public users have a greater interest in supplementary information than private users.An effective financial report should communicate useful information about an entity to facilitate rational decisions by its important constituents, with respect to economic issues.An important function of accounting and financial reporting is to assist in the analysis and evaluation of organizations. Currently, much is known about how investors and creditors use the financial statements of business entities. However, less is understood about how the financial statements of not-for-profit (NFP) organizations play a role in charitable giving. The decision-makers are donors, and the decisions are whether to make a charitable contribution and how much to contribute. The dependent variable "donations" represents the capital that contributors invest in non-profits.

11. The overall performance of NPEs is best measured by a set of factors that reflect the multiple and diverse stakeholders associated with charities:
(1) financial measures;
(2) client satisfaction;
(3) management effectiveness;
(4) stakeholder involvement;and
(5) benchmarking,

12. Integrated Reporting is a new reporting paradigm that is holistic, strategic, responsive, material and relevant across multiple time frames. Emphasising enhanced disclosure of the value drivers for today's organisations, Integrated Reporting represents a journey to more

meaningful reporting that can be instrumental for reporting organisations thar are not-for-profits.

13. NPEs mainly focused on the link between financial accounting and taxation, indicating that the use of accounting discretion is motivated by the effort to minimize taxation. Therefore there is a need for shifting the focus of NPEs from taxation to disclosure.

14. A number of factors may be taken into account when assessing the materiality of information. These include:

— Business model, strategy and principal risks: a company's goals, strategies, management approach and systems, values, tangible and intangible assets, value chain and principal risks are relevant considerations.

— Main sectoral issues similar issues are likely to be material to companies operating in the same sector, or sharing supply chains. Topics already identified by competitors, customers or suppliers are likely to be relevant for a company

— Interests and expectations of relevant stakeholders: companies are expected to engage with relevant stakeholders and seek a good understanding of their interests and concerns.

— Impact of the activities: Companies are expected to consider the actual and potential severity and frequency of impacts.

This includes impacts of their products, services, and their business relationships (including supply chain aspects).

— Public policy and regulatory drivers: Public policies and regulation may have an effect on the specific circumstances of a company, and may influence materiality

Chapter II

Financial Statements

General Instructions for Preparation of Statement of Profit and Loss

This part requires following modifications:

2. (A) Revenue from operations shall disclose separately in the notes revenue from—

(a) Sale of products;

Less: Excise duty/Goods & Services tax (GST)/VAT

(b) Sale of services;

Less: Goods & Services tax (GST)

(c) Other operating revenues;

Less: Goods & Services tax (GST)

(B) In respect of a finance non-corporate entity, revenue from operations shall include revenue from—

(a) Interest; and

(b) Other financial services.

Less: Goods & Services tax (GST)

The ED has no format of Income & Expenditure statement and Receipts & Payments statement for Not-for-profit entities.

The ED has no Illustrative Formats of Cash Flow statement. Though no requirement to prepare cash flow statement by non-business entities under any law, it is essential for 'Not-for-profit entities' to monitor the movement of funds by Donors. Therefore, it is suggested that the following two methods of 'Cash Flow statement' may be incorporated.

CONSOLIDATED CASH FLOW STATEMENT {Direct Method]
Year ended 31 March

NOTE No. 20Xx 20Xx		
Rs. '000 Rs.'000		
NET CASH FLOW FROM OPERATING ACTIVITIES	XX	XX
RETURNS ON INVESTMENTS AND SERVICING OF FINANCE		
Interest received	X	X
Interest paid	(XX)	(XX)
Interest element of finance lease rentals payments	(X)	(X)
Net cash outflow from returns on investments and servicing of finance (XX)		(XX)
TAXATION		
Income tax paid	(XX)	(XX)
CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT		
Payments to acquire tangible fixed assets	(XX)	–
Receipts from sale of tangible fixed assets	XX	X
Payments for additions to investments	(XX)	(X)
Receipts from sale or withdrawal of investments	XX	XX
Net cash inflow from capital expenditure and financial investment	X	X
ACQUISITIONS AND DISPOSALS		
Purchase of subsidiary undertakings	(X)	–
Sale of business	XX	X
Net cash inflow from acquisitions and disposals	XX	X
MANAGEMENT OF LIQUID RESOURCES		
Net movement in short term deposits	X	XX
Net purchase of short term investments	(X)	(X)
Net cash inflow from management of liquid resources X XX		
FINANCING		
Net repayment of loans	(XX)	(XX)
Capital element of finance lease rental payments	(X)	(X)
Net cash outflow from financing	(XX)	(XX)
DECREASE IN CASH AND CASH EQUIVALENTS	(XXX)	(XX)

CASH FLOW STATEMENT – (INDIRECT METHOD)

1. Net income/loss for the period (including minority interest) before extraordinary items
2. +/– Depreciation on/write-ups to fixed assets
3. +/– Increase/decrease in accruals
4. +/– Other cash outflows/inflows (e.g. depreciation on discounts capitalised)
5. –/+ Gain/loss on disposal of fixed assets
6. –/+ Increase/decrease in inventories, trade receivables and other assets not related to investment or financing activities
7. +/– Increase/decrease in trade payables and other liabilities not related to investment or financing activities
8. +/– Cash inflows and outflows from extraordinary items
9. = Cash flow from current business activities (= total 1 to 8)
10 Cash inflow from disposal of tangible assets
11. – Cash outflow from capital expenditure on tangible assets
12. + Cash inflow from disposal of tangible assets
13. – Cash outflow from investments in intangible fixed assets
14. + Cash inflow from disposal of financial assets
15. – Cash outflow from investments in financial assets
16. + Cash inflow from disposal of consolidated enterprises and other business units
17. – Cash outflow from acquisition of consolidated enterprises and other business units
18. + Cash inflow from financial investments within the scope of short-term cash management
19. – Cash outflow from financial investments within the scope of short-term cash management
20. = Cash flow from investment activities (= total 10 to 19)
21. Cash inflow from capital contributions
22 Repayment of capital,
23. + Cash inflow from granting of loans and raising of (finance) loans
24. – Cash outflow from repayment of loans and (finance) loans
25. = Cash flow from financing activities (= total 21 to 24)
26. Change in cash and cash equivalents (= total of 9, 20, 25)
27. +/– Changes in cash and cash equivalents on account of changes of exchange rates, to the group of consolidated entities and valuation-related changes
28. + Cash and cash equivalents at beginning of period
29. = Cash and cash equivalents at end of period (= total 26 to 28)

Chapter VI
Formats of Financial Statements for Non-corporate Entities

In this Chapter there are Formats of Financial Statements for Non-corporate Entities with Notes as ‘General Instructions’. Again, under Appendix B, there are Illustrative Formats of Financial Statements with ‘Notes forming part of the Financial Statements’. To avoid duplication of financial statements the ‘Notes forming part of the Financial Statements’ may be merged with Chapter: VI Format.