Chapter 8 – Notes

Key points

- The notes are an integral part of the financial statements.
- The notes provide:
    - o information about the significant accounting policies applied by the entity;
    - o additional information about items included in the primary financial statements (for example, a breakdown of classes of property, plant and equipment); and
    - o information about transactions or events that is not apparent from the primary financial statements (for example, transactions with related parties).
- An item is material if its inclusion or exclusion from the financial statements would be likely to change a user's judgements made on the basis of the statements. The concept of materiality is used to decide whether certain items need to be disclosed in the financial statements. A not-for-profit entity does not need to make disclosures specified by a financial reporting standard if the information is not material. In addition, the concept of materiality can be used to decide whether the application of a particular financial reporting treatment to a transaction or balance as opposed to an alternative treatment has a material impact on the financial statements.

Introduction

8.1 This chapter covers the following issues:

- the reason for notes;
- the financial reporting standards a not-for-profit entity must comply with;
- how a not-for-profit entity selects an accounting policy if there is no specific standard or interpretation;
- the types of accounting policy disclosures required;
- what a not-for-profit entity needs to do if it changes its accounting policies;
- whether there is an easy way to identify the disclosures required by New Zealand equivalents to International Financial Reporting Standards (NZ IFRSs);
- note disclosures that are likely to be specific to not-for-profit entities; and
- disclosures required in respect of changes in accounting estimates, prior period errors, judgements, key sources of estimation uncertainty, contingent assets and liabilities, commitments and financial risk management.

8.2 General purpose financial statements prepared in accordance with NZ IFRSs must contain notes. NZ IAS 1 *Presentation of Financial Statements* sets out requirements for the layout and content of the notes.

8.3 NZ IAS 1 states that the notes must (NZ IAS 1 paragraphs NZ 13.1, 105 and NZ 105.1):

- present information on the financial reporting standards (the accounting policies) applied by the entity;
- present information about the basis of preparation of the financial statements and the specific accounting policies;
- disclose information that is required but which is not presented on the face of individual statements; and
- provide additional information that is relevant to an understanding of the individual statements.

8.4 This information is usually presented in the order shown above. The notes should be presented in a systematic manner. Each item on the face of the financial statements should be cross-referenced to any related information in the notes.

Accounting policies

8.5 Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

8.6 The objective of a summary of accounting policies is to help readers of the not-for-profit entity's financial statements understand the material principles, bases and rules used to report the entity's financial and non-financial performance, financial position and cash flows. Such information is essential for readers to interpret the financial statements and is usually presented as a separate statement or as the first note to the financial statements.

8.7 NZ IAS 1 specifies the general requirements regarding disclosure of accounting policies, while NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* contains more detailed requirements regarding changes in accounting policies.

8.8 The summary of accounting policies includes:

- a statement of compliance;
- general accounting policies, including a description of the reporting entity;
- specific accounting policies; and
- changes in accounting policies (if applicable).

8.9 Each of these topics is discussed below.

Statement of compliance

8.10 A not-for-profit entity is required to disclose the following information regarding compliance with financial reporting standards:

- the statutory base (that is, the legislation), if any, under which the financial statements are prepared;
- whether, for the purposes of complying with generally accepted accounting practice in New Zealand (NZ GAAP), it is a profit-oriented or public benefit entity [46];
- where applicable, the criteria which establish the not-for-profit entity as a qualifying entity for differential reporting and the extent to which the entity has applied available differential reporting concessions; and
- a statement that the financial statements have been prepared in accordance with NZ GAAP, together with a description of the financial reporting standards applied by the not-for-profit entity.

8.11 For example, a not-for-profit entity applying differential reporting concessions could state: "The financial statements have been prepared in accordance with New Zealand GAAP. They comply with New Zealand equivalents to International Financial Reporting Standards, and other applicable Financial Reporting Standards, as appropriate for public benefit entities that qualify for and apply differential reporting concessions." As long as all the requirements of NZ IAS 1 are met these assertions could be made in different ways.

General accounting policies

8.12 Although the exact location of information within the summary of accounting policies is up to the not-for-profit entity, the general accounting policies usually include:

- a description of the reporting entity (NZ IAS 1 paragraph 126) [47];
- the fact that the financial statements have been prepared on the accrual basis;
- a statement that the not-for-profit entity is a going concern;
- a description of the measurement bases used (NZ IAS 1 paragraph 108);
- the presentation currency (NZ IAS 1 paragraph 46(d)); and
- where applicable, reference to the location of the disclosures and reconciliations required on first-time adoption of NZ IFRSs.

Reporting entity

8.13 A description of the not-for-profit reporting entity will include the following information:

- the name of the not-for-profit entity (and, if the entity is part of a group the name of the entity's parent and the ultimate parent of the group);
- the legal form of the not-for-profit entity, whether it is incorporated and where it is domiciled;
- the nature of the not-for-profit entity's operations and its principal activities;
- a statement that the not-for-profit entity is a public benefit entity [48];
- the names of any subsidiaries and associates; and
- the registered office (or principal place of business, if different from the registered office).

Going concern

8.14 If the financial statements are prepared on a going concern basis but there is significant doubt about the entity's ability to continue as a going concern, the reasons for the doubt must be disclosed (NZ IAS 1 paragraph 22). Where a not-for-profit entity is a going concern by virtue of the continued funding of the main funding body, or the successful

[46] This Guide assumes that all not-for-profit entities are public benefit entities. Refer Chapter 1.
[47] This information may be disclosed elsewhere in information published with the financial statements.
[48] This Guide assumes that all not-for-profit entities are public benefit entities. Refer Chapter 1.

renegotiation of existing contracts for service, it is common for the entity to put a note to its financial statements to this effect and the governing body's opinion as to the likelihood of continuation. If the going concern basis has not been used in preparing the financial statements, this must be disclosed, along with the reasons and a description of the basis that has been used (NZ IAS 1 paragraph 23).

Measurement bases

8.15 Measurement bases include historical cost, current cost, net realisable value, fair value and recoverable amount. If more than one measurement base is used in the financial statements an entity indicates the categories of assets and liabilities to which each measurement basis is applied. Usually a summary of the measurement bases is given in the general accounting policies and the measurement basis used for each class of assets or liabilities is repeated in the specific accounting policy section.

8.16 A description of the measurement bases used could be: "The financial statements are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: foreign exchange contracts, shares held for trading, shares classified as available-for-sale, and land and buildings. Non-current assets held for sale are valued at the lower of carrying amount and fair value less costs to sell."

Selection and application of accounting policies

8.17 If the method of accounting for a transaction or event is covered by a New Zealand financial reporting standard, that standard should be used (NZ IAS 8 paragraph 7). However, if there is no standard that specifically applies to a transaction, event or condition, NZ IAS 8 (paragraphs 10 to 12) provides guidance on selecting an appropriate accounting policy. The objective is to select an accounting policy that results in relevant and reliable financial information (NZ IAS 8 paragraph 10).

8.18 NZ IAS 8 specifies the following guidance for an entity's management to use when selecting accounting policies, in descending order of authority:

- requirements of standards and interpretations dealing with similar matters;
- the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements* (NZ *Framework);*
- the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework, other accounting literature and accepted industry practices, to the extent that these do not conflict with standards, interpretations or the NZ *Framework* (NZ IAS 8 paragraphs 11 and 12).

8.19 The process of selecting accounting policies requires judgement. The qualitative characteristics of reliability and relevance are used to guide management in making this judgement.

8.20 The NZ *Preface* (paragraph 39) gives examples of sources of authoritative support. Technical Practice Aids issued by the Financial Reporting Standards Board are an example of pronouncements of a recognised standard setting body and therefore are a source of guidance that may be used in developing and applying accounting policies. Other examples of pronouncements of standard-setting bodies include:

- International Public Sector Accounting Standards (IPSASs) issued by the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC);
- financial reporting standards issued by the Australian Accounting Standards Board (AASB); and
- financial reporting standards issued by well-recognised bodies with the authority to promulgate financial reporting standards in jurisdictions such as Canada, the United Kingdom and the United States of America.

8.21 Not-for-profit entities frequently have transactions and events that are not specifically covered by New Zealand financial reporting standards. The most common problem is how to account for non-exchange transactions, which are not covered in NZ IFRSs. In discussing such transactions this Guide has made reference to IPSAS 23 *Revenue from Non-Exchange Transactions* (*Including Taxes and Transfers*). The disclosure of accounting policies is particularly important when there is no relevant New Zealand standard.

8.22 Once selected, accounting policies should be consistently applied, unless a standard permits otherwise.

Specific accounting policies

8.23 In addition to the measurement bases used, NZ IAS 1 requires that an entity disclose the other accounting policies used that are relevant to an understanding of the financial statements (NZ IAS 1 paragraph 108). However, NZ IAS 1 does not specify which accounting policies must be disclosed. It suggests that disclosure is particularly useful when alternatives exist (NZ IAS 1 paragraphs 110 to 112).

8.24 Examples of accounting policies disclosed by not-for-profit entities because they are relevant to an understanding of the financial statements include the following.

Statement of financial position

- Property, plant and equipment (including heritage assets) – disclose:
  - whether using cost or revaluation models;
  - components of cost;
  - subsequent costs;
  - the policies used for leased assets if applicable;
  - the methods and rates of depreciation;
  - the basis of impairment; and
  - the treatment of restrictions and conditions on property, plant and equipment.
- Intangible assets – disclose the policy in respect of software and any research and development costs (note that some differential reporting exemptions are available).
- Investments – disclose the nature of investments, the NZ IAS 39 designations used for financial assets and the justification for using those designations.
- Trade and other receivables – disclose the measurement basis and basis of impairment.
- Inventories – disclose the measurement of inventories, including the method of determining cost of inventories. Explain the treatment of any inventories held for distribution at no or nominal value.
- Impairment – disclose how frequently impairment reviews are conducted, the policy for recognition of impairment losses, the method of determining estimated recoverable amount, and the policy regarding reversals of impairment losses (if applicable).
- Borrowings – disclose the measurement basis used.
- Employee benefits – disclose the policy for the recognition of liabilities/expenses in relation to defined contribution pension plans and long-service leave.
- Provisions – disclose the policy for the recognition and measurement of provisions and any onerous contracts.
- Trade and other payables – disclose the measurement basis used.

Statement of financial performance

- Membership fees – disclose the policy for the recognition of fees, including the treatment of any life membership fees.
- Grant and donation income – disclose the policies for the recognition of grants and donated goods and services and the circumstances in which any conditions or restrictions are recognised as liabilities or otherwise highlighted in the financial statements.
- Fundraising income and expenses – disclose the types of fundraising methods used, the policies used for recognising fundraising income and expenses, including the policy used to estimate cash collected and held by others at the end of the reporting period.
- Investment income – disclose the policy for recognition and measurement of investment income.
- Trading revenue – disclose the policy for recognition and measurement of trading income.
- Grant and donations expense – disclose the policy for the point at which grants and donations are recognised as an expense.
- Operating and finance leases – disclose the policy for the recognition and measurement of expenses associated with lease payments.
- Financing costs – describe items classified as financing costs (including gains and losses on financial instruments), and the policy for the recognition and measurement of each type.
- Income tax – disclose if tax exempt. If not tax exempt disclose a description of the method adopted in accounting for income tax (some differential reporting exemptions are available).

Cash flow statement

- Cash flows – disclose the nature of items classified as cash, operating activities, investing activities and financing activities.

Other

- GST – disclose the method of accounting for GST (some differential reporting concessions are available).
- Business combinations – disclose the methods by which individual subsidiaries, associates and joint ventures have been accounted for. Disclose the policies used for measuring goodwill (see also intangible assets) and minority interest.

8.25 In relation to the statement of service performance, the summary of accounting policies should disclose:

- the basis of aggregation of individual outputs; and
- the basis by which costs are allocated to outputs.

Changes in accounting policies

8.26 If there have been no changes in accounting policies an entity states this fact in the summary of accounting policies. An entity is permitted to change an accounting policy only if the change:

- is required by a standard or interpretation; or
- results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance, or cash flows (NZ IAS 8 paragraph 14).

8.27 The adoption of an accounting policy for new transactions or events is not a change in accounting policy (NZ IAS 8 paragraph 16). An entity will not have any accounting policy changes in its first year of adoption of NZ IFRSs. This is because an entity is required to use the same accounting policies in its opening NZ IFRS statement of financial position and throughout all periods presented in its first NZ IFRS financial statements (NZ IFRS 1 paragraph 7).

8.28 If a change in accounting policy is required by a standard or interpretation, the change is accounted for in accordance with that standard or interpretation. Generally this involves retrospective application (restating comparative amounts as if the policy had always been applied) but there are occasionally transitional provisions that do not require retrospective application (NZ IAS 8 paragraphs 19 and 22).

8.29 If a change in accounting policy is voluntary NZ IAS 8 requires retrospective application of the policy. However, it does allow an exception in cases where it is impracticable to determine the effects of the change (NZ IAS 8 paragraphs 24 and 25).

8.30 When a not-for-profit entity changes accounting policies in accordance with a standard or interpretation it must provide a number of disclosures, including (NZ IAS 8 paragraph 28):

- the title of the standard or interpretation causing the change;
- the nature of the change in accounting policy;
- a description of the transitional provisions, including those that might have an effect on future periods; and
- the amount of the adjustment for the current period and each prior period presented, to the extent practicable.

8.31 Similar disclosures are required in respect of voluntary changes in accounting policies. In addition a not-for-profit entity must justify the reason for making the change (NZ IAS 8 paragraph 29).

Additional information about the primary financial statements

8.32 As well as the information required to be disclosed on the face of the financial statements, financial reporting standards often require additional information about transactions and events to be disclosed in the notes. Some of these disclosures have been discussed in previous chapters. For example, NZ IAS 16 requires additional information on revalued assets (NZ IAS 16 paragraphs NZ 77.2 and NZ 77.3).

8.33 Differential reporting concessions significantly reduce the amount of information required to be disclosed in the notes [49]. Not-for-profit entities applying differential reporting concessions are still encouraged to consider whether such disclosures would help readers fully interpret the entity's financial reports. Some disclosures which are not required but could be helpful include:

- revenue from subscriptions and membership fees;
- revenue from grants, donations, legacies and endowments;
- donations of in-kind goods and services;
- details of restricted versus unrestricted equity;
- a breakdown of debtors (subscriptions, trading and other);

[49] Please refer to each Standard for a description of the differential reporting concessions in that Standard.

- details of grants and donations made (such as aggregate amounts of grants made to major recipients, taking privacy concerns into account) and intended to be made from future income;
- loans on concessionary terms; and
- restrictions or conditions on donated assets.

8.34 A number of financial reporting standards require a not-for-profit entity to disclose details of the changes between opening and closing balances of asset and liability accounts. Although there are some concessions for small to medium sized entities, where applicable, such not-for-profit entities must disclose:

- a reconciliation between the carrying amount at the beginning and the end of the period of each component of equity (NZ IAS 1 paragraph 97)
- by each class of property, plant and equipment, details of impairment losses recognised, impairment losses reversed and depreciation (NZ IAS 16 paragraphs 73(e)(v) to 73(e)(vii));
- a reconciliation of the carrying amount of goodwill at the beginning and end of the period (NZ IFRS 3 paragraphs 74 and 75);
- a reconciliation of the net exchange differences classified in a separate component of equity (NZ IAS 21 paragraph 52);
- a reconciliation between the carrying amounts of investment property at the beginning and end of the period (NZ IAS 40 paragraph 76); and
- by lessees in respect of finance leases, a reconciliation between the total of minimum lease payments at the balance sheet date, and their present value (NZ IAS 17 paragraph 31).

Changes in accounting estimates and prior period errors

8.35 Changes in accounting estimates must be disclosed (NZ IAS 8 paragraphs 32 to 40). The carrying amounts of assets and liabilities are reassessed periodically in accordance with financial reporting standards. These changes to carrying amounts result from new information and are not errors. The effect of these changes is recognised by adjusting the carrying amount of the relevant item and by recognising the adjustment as income or expense in the statement of financial performance.

8.36 A prior period error is something left out or incorrectly stated in financial statements for one or more earlier periods, and which was caused by misusing or not using reliable information that:

- was available when the financial statements for those periods were authorised for issue; and
- could reasonably be expected to have been taken into account in preparing those financial statements.

8.37 Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud (NZ IAS 8 paragraph 5).

8.38 An entity must correct material prior period errors as soon as possible after discovery. The correction is made to the relevant prior period comparatives, or if the error occurred in an earlier period, to the opening balances of the relevant items (NZ IAS 8 paragraph 42). Some exceptions are allowed if restatement is impracticable (NZ IAS 8 paragraphs 43 to 48).

8.39 Details of material prior period errors must be disclosed (NZ IAS 8 paragraph 49).

Additional financial information

8.40 Financial reporting standards also require disclosure of information about transactions or events that is not apparent from the primary financial statements. Such disclosures include:

- related party transactions and events;
- contingent assets and liabilities;
- commitments; and
- objectives for managing capital (refer Chapter 6).

Related party disclosures

8.41 The objective of related party disclosures is to make sure that users of the financial statements are aware that an entity's financial performance or position may have been affected by transactions with related parties that are on terms and conditions more or less favourable than transactions with other parties. Related party disclosures are as relevant for not-for-profit entities as they are for other entities.

8.42 Related parties are defined in NZ IAS 24 *Related Party Disclosures* (paragraph 9). The definition states that a party is related to an entity if:

(a) directly, or indirectly through one or more intermediaries, the party:
   (i) controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries);
   (ii) has an interest in the entity that gives it significant influence over the entity; or
   (iii) has joint control over the entity;

(b) the party is an associate (as defined in NZ IAS 28 *Investments in Associates*) of the entity;

(c) the party is a joint venture in which the entity is a venturer (see NZ IAS 31 *Interests in Joint Ventures*);

(d) the party is a member of the key management personnel of the entity or its parent;

(e) the party is a close member of the family of any individual referred to in (a) or (d);

(f) the party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or

(g) the party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.

8.43 For not-for-profit entities, related parties are likely to be members of the governing body and persons with a family or business connection with them. Related parties may also be entities controlled by the same governing body. Key management personnel is defined in NZ IAS 24 as "Those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity." The key management personnel of a not-or-profit entity would generally include the Board and the senior manager of the entity (where such a position exists).

8.44 The requirements for related party disclosures are set out in NZ IAS 24. The disclosures made by a not-for-profit entity with no controlled entities and that qualifies for differential reporting concessions, would include:

- the nature of the related party relationship;
- the amount of the transaction;
- the amount of outstanding balances and information on the terms and conditions and any guarantees given or received (an entity can claim that the terms of a related party transaction were the same as those in an arm's length transaction only if they can provide proof). A common disclosure by not-for-profit entities is that "Services are provided to members of the Board on the same terms and conditions as they are provided to other recipients of the entity's services";
- provisions for doubtful debts in relation to outstanding balances; and
- any bad or doubtful debts expense in respect of related party transactions (NZ IAS 24 paragraphs 17 and 21).

8.45 These disclosures do not need to be made in respect of each individual transaction – they may be aggregated by type of related party (NZ IAS 24 paragraph 18). For example, loans and payments to members of the governing body could be disclosed as one category. Any material transactions should be separately disclosed.

8.46 Entities with controlled entities (subsidiaries) would need to make additional disclosures in accordance with NZ IAS 24.

8.47 Entities that qualify for differential reporting concessions do not need to disclose compensation to key management personnel as required by NZ IAS 24. However, such entities must still disclose other transactions with key management personnel. If a not-or-profit entity chooses to disclose compensation to key management personnel in accordance with NZ IAS 24 it must disclose the total compensation and a breakdown by type of compensation. The definition of compensation in NZ IAS 24 is broad – it includes the types of remuneration covered by NZ IAS 19 *Employee Benefits* and NZ IFRS 2 *Share-based Payment.*

Contingent assets and liabilities

8.48 The notes present information on any contingent assets or liabilities. Examples of transactions or events giving rise to contingent assets or liabilities are bequests where there is insufficient information to reliably measure the fair value of the bequest, claims, pending or threatened litigation, and guarantees of others' debt.

8.49 The definitions of these items and the accounting treatment required are shown in Table 12. The standard covering these items is NZ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*

TABLE 12: DEFINITIONS AND TREATMENT OF CONTINGENT ASSETS AND LIABILITIES

	Contingent liability	Contingent asset
Definition	A contingent liability is: (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or (b) a present obligation that arises from past events but is not recognised because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or (ii) the amount of the obligation cannot be measured with sufficient reliability. (NZ IAS 37 paragraph 10)	A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. (NZ IAS 37 paragraph 10)
Recognition	Do not include contingent liabilities as liabilities in the statement of financial position. (NZ IAS 37 paragraph 27) The exception is contingent liabilities assumed as part of a business combination. (NZ IFRS 3 paragraph 36)	Do not include contingent assets as assets in the statement of financial position. (NZ IAS 37 paragraph 31)
Measurement	NZ IAS 37 contains guidance on measurement.	NZ IAS 37 contains guidance on measurement.
Disclosure	Unless the possibility of any outflow in settlement is remote, an entity must disclose for each class of contingent liability at the reporting date a brief description of the nature of the contingent liability and, if practicable: (a) an estimate of its financial effect; (b) an indication of the uncertainties relating to the amount or timing of any outflow; and (c) the possibility of any reimbursement. If it is not practicable to make one or more of these disclosures, that fact must be stated. (NZ IAS 37 paragraphs 86 and 92)	If an inflow of economic benefits is probable, an entity must disclose a brief description of the nature of the contingent assets at the reporting date, and, if practicable, an estimate of their financial effect. If it is not practicable to make this disclosure, that fact must be stated. (NZ IAS 37 paragraphs 89 and 92)

Commitments

8.50 Disclosure of contractual commitments for the acquisition of property, plant and equipment is required by NZ IAS 16 *Property, Plant and Equipment* (paragraph 74). Such commitments represent a firm intention at the end of the reporting period to incur capital expenditure in the future. The commitments referred to by NZ IAS 16 are items which do not yet meet the recognition criteria for liabilities. A commitment generally arises when an order is placed or a contract signed. The subsequent liability generally arises when the services are complete or when the goods have been received.

8.51 NZ IAS 17 *Leases* requires the disclosure of future minimum lease payments in relation to finance leases and non-cancellable operating leases (NZ IAS 17 paragraphs 31 and 35). The finance lease commitments are recognised as liabilities in the statement of financial position and the purpose of the note disclosure is to provide more information about those liabilities. Operating lease commitments are not recognised as liabilities. Non-cancellable operating leases often relate to property or office equipment.

Risk management

8.52 NZ IFRS 7 *Financial Instruments*: *Disclosures* governs the disclosure of financial instruments. One of its key requirements is that an entity must disclose information that enables readers of its financial statements to evaluate the nature and extent of risks arising from financial instruments. This would include disclosure of its financial risk management objectives and policies (NZ IAS 1 paragraph 105(d)(ii)). An explanation of the reasons for the use of any derivatives should be provided as part of the discussion of risk.