

1. INTRODUCTION

1.1 NPOs: Definition, characteristics and scope.¹

Traditionally, definitions of the nonprofit sector, also referred to as “civil society,” “third sector,” “NGO sector,” “social economy,” “voluntary sector,” and “social sector,” have revolved around three aspects: its sources of economic support, its legal status and its purposes.

According to the first set of definitions, an NPO is an organization whose primary source of revenue is made up of contributions from the private sector, differentiating it from those who are supported by market transactions or government resources.

The second set of definitions places an organization’s legal personality as the defining characteristic of NPOs, which are then identified as organizations that are exempt from some, if not all, of a country’s taxes.

The third and last set of definitions emphasize the purposes that an organization chooses to pursue, stressing that an NPO is one that promotes the public good, encourages empowerment and participation, or seeks to address the structural roots of poverty and distress.

However, Salamon, Sokolowski and List, in the book, *Global Civil Society: Dimensions of the Nonprofit Sector*, point out that these definitions are insufficient insofar as providing a holistic view of the NPO sector.

Focusing on sources of revenue, they say, downplays other features that NPOs may share, such as their use of volunteers, their social missions and their not-for-profit character, while emphasizing legal personality is made difficult to apply comparatively by the significant differences that exist between each country’s legal structure. Lastly, while purpose definitions may be the most appealing of the three, Salamon, Sokolowski and List say that they are “too subjective,” as the idea of what constitutes “public purpose,” may vary across countries and sectors. In addition to the fact that it is difficult to determine whether or not a particular organization is actually pursuing their declared

¹ Taken from Salamon, Sokolowski et al. *Global Civil Society: Dimensions of the Nonprofit Sector*.

purpose, they also point out that this raises the possibility of making any NPO's pursuit of public purposes true by definition, making such claims difficult to disprove.

Given these limitations surrounding traditional definitions, the study on global civil society yielded a consensus on five structural-operational features that defined organizations within the NPO sector:

- *Organized*, i.e., they have some structure and regularity to their operations, whether or not they are formally constituted or legally registered. More than legal or formal recognition, this qualification stresses organizational permanence and regularity, reflected in regular meetings, a membership, and legitimate decision-making structures and procedures.
- *Private*, i.e., they are not part of the apparatus of the state, even though they may receive support from governmental sources.
- *Not profit-distributing*, i.e., they are not primarily commercial in purpose and do not distribute profits to a set of directors, stockholders, or managers. While NPOs may generate a surplus from time to time, they must reinvest these resources back into the objectives of their respective organizations.
- *Self-governing*, i.e., they have their own mechanisms for internal governance, are able to cease operations on their own authority, and are fundamentally in control of their own affairs.
- *Voluntary*, i.e., membership or participation in them is not legally required or otherwise compulsory.

This fivefold definition encompasses organizations both formal and informal, religious and secular, those with paid staff and those staffed entirely by volunteers and organizations performing expressive functions (i.e., advocacy, cultural expression, community organizing, environmental protection, human rights, religion, representation of interests, and political expression) as well as those performing service functions (i.e., provision of health, education and welfare services). This description does not take into account individual forms of citizen action such as voting or writing to legislators, but it embraces most organized forms, including social movements and community-based cooperatives serving solidarity objectives. Government agencies, private businesses, commercial cooperatives and mutuals have been deliberately excluded.

Scope

This Accounting Guide shall apply to organizations that meet all the Unique Characteristics of an NPO and any or all of the Additional Characteristics as described above. For other organizations or entities, they should apply the accounting standards set for business enterprises or public sector.

Because of the nature of their operations, some NPOs, such as schools and hospitals, can be considered to be similar to commercial concerns for the purpose of applicability of accounting standards for NPOs.

Exemption from Applicability of the Accounting Guide

There is a wide spectrum of NPOs in terms of size, level of operation, operating fund, and number of personnel. Smaller NPOs may not be able to have the resources and capability to adopt some of the prescribed guidelines.

It is recommended and encouraged that this guide applies to all NPOs. The adoption of this guide, will lead to a significant improvement in the quality of general purpose financial reporting by NPOs. This, in turn, is likely to lead to better informed assessments of the resource allocation decisions made by NPOs, thereby increasing transparency and accountability. However, where local laws allow exemptions from following standards, small organizations may be exempted until they are capable to follow the standards and guidelines. Furthermore, this Accounting Guide acknowledges the right of national standard-setting bodies to establish accounting standards and guidelines for financial reporting in their jurisdictions. It may assist such standard-setting bodies in the development of new standards or in the revision of existing standards in order to contribute to greater comparability.

It is important to note that there is a need for small NPOs to undergo capacity-building activities for them to follow the standards and guidelines. The standards and guidelines are not merely technical requirements but more importantly, are tools to efficiently and effectively manage NPOs.

1.2 The Role of the NPOs in Society

According to Boutros-Ghali in 1995, “Non-governmental organizations are a basic element in the representation of the modern world. And their participation in international organizations is in a way a guarantee of the latter’s political legitimacy... From the stand point of global democratization, we need the participation of international public opinion and the mobilizing powers of non-governmental organizations.”

The World Bank also describes non-government organizations (NPOs) as:

“...include many groups and institutions that are entirely or largely independent of government and that have primarily humanitarian or cooperative rather than commercial objectives. They are private agencies in industrial countries that support international development; indigenous groups organized regionally or nationally; and member-groups in villages. NPOs include charitable and religious associations that mobilize private funds for development, distribute food and family planning services and promote community organization. They also include independent cooperatives, community associations, water-user societies, women’s groups and pastoral associations. Citizen groups that raise awareness and influence policy are also NPOs”

Today, the increasing role of NPOs in society is more pronounced, from relief services (logistics management) to development services (strategic management) to arts and culture. They also contribute in creating a more inter-dependent global community.

1.3 NPO Stakeholders

STAKEHOLDERS	EXPECTATIONS(Social and Economic)
1. Members/Beneficiaries	1. Services, ROI, Social Justice
2. Governing Board	2. Prestige, Self-reliance
3. Management/Staff	3. Better career
4. Donors	4. Attainment of the purpose/s of funds Compliance with agreements
5. Government	5. Regulation Partnership in Development
6. Volunteers	6. Contribution to the development of specific concerns
7. General Public	7. Contribution to the development of society, in general

1.4 NPO Governance and Accountability

For NPOs to fulfill their goals and objectives as well as to realize stakeholders' expectations efficiently and effectively, they must be governed by the principles of Fairness, Accountability, and Transparency. Fairness - rights of stakeholders should be observed and respected; Accountability - Board and management should be answerable on their performance to stakeholders; Transparency - timely, accurate and sufficient information must be disclosed.

The foremost responsibility for NPOs is to be accountable to the needs and aspirations of the community it is working with since serving community interests is the stated primary goal of most NPOs. In practice, these communities lack mechanisms for holding NPOs accountable. Unlike donors, communities cannot withdraw their funding; unlike governments, they cannot impose conditionalities.

NPOs are also accountable to its donors, who may be both external (for example, governments, foundations, or other NPOs) and internal (members who contribute smaller amounts). The simplest level of responsibility is that of spending money for the purpose to which it has been designated.

Lastly, NPOs are also accountable to its organization. They are responsible to their stated mission, governing board, management and staff, partners, and to the NPO community as a whole.

Financial accounting in NPOs, the topic of this guide, hopes to contribute significantly to helping NPOs increase their capacity to express accountability to their different stakeholders.

1.5. Rationale

NPOs as a Sector

The UNDP² describes NPOs as the “third sector”, the first and second being the government and private sectors. This is in recognition of the distinct characteristics of NPOs from other forms of organization especially from the commercial ones. Several studies reveal that NPOs contribute significantly to the development of society and the economy.

In many countries, accounting pronouncements cater to the needs of commercial organizations. Although fundamental accounting principles apply to any type of organization, appropriate standards and guidelines for NPOs are needed to fit the specifications and peculiarities of these organizations. Basic differences between commercial organizations and NPOs include the following:

- 1) NPOs do not operate primarily for profit but for specific needs of a community, group, organization or its membership.
- 2) Most of NPOs revenues come from funds contributed, donated, granted or given as other forms of support. Revenues from income generating activities, if any, are eventually plowed back to program operations.

Unlike in the business community where an exchange transaction occurs, in non-profit organizations, resource providers do not expect to receive either repayment or economic benefits proportionate to the resources provided. There is no defined ownership interest that can be sold, transformed or redeemed or that convey entitlements to a share to a residual distribution of resources in the event that the organization is dissolved.

- 3) NPOs have the responsibility to account for these funds designated for a specific purpose for a specified period of time. The nature of the revenues received requires ensuring that separate types of funds are properly tracked and reported.

The Need for Financial Accounting Standards & Guidelines for NPOs

To date, comprehensive guidelines on accounting issues unique to NPOs have yet to be developed at the international level. Some pronouncements made by standards-setting bodies covering NPOs have been developed in the United States and recently in China. Likewise in India, the Technical Guide on Accounting and Auditing on NPOs was issued by the Institute of Chartered Accountants of India. Also, the Proposed Financial Accounting Standards for NPOs in the Philippines is being reviewed by the Accounting Standards Council of the Philippines. However, many countries are either practicing *de facto* standards for NPOs or applying current pronouncements in their respective countries to NPOs which may or may not be totally apt to the nature of these

² UNDP = United Nations Development Programme

organizations. Although all accounting applications are based on the same set of principles, the importance of adopting the specifications and particularities of the NPO community, as a sector, is paramount for uniform interpretation and analysis of financial reports. The resultant diversity of accounting practices has provided the ingredients for the need to standardize accounting practices.

APPC has conducted various consultations and conferences in and among eight Asian societies with the general objective of proposing a set of Financial Accounting Standards for NPOs in the region. The consultations and conferences were attended by NPO representatives, government officials, accountants & auditors. The initial outcome of these processes was an Issues Paper on the proposed financial accounting standards, from which this subsequent Accounting Guide was created to provide concrete guidelines in the accounting of NPO transactions.