

DISCLOSURE OF INCOME AND EXPENSES IN THE FINANCIAL STATEMENTS OF NON-PROFIT ORGANIZATIONS: PROBLEMS AND SOLUTIONS

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Abstract: *The widespread globalization of economic processes and the involvement of participants from different countries in the activities of non-profit organizations impose special requirements on the content and form of presentation of financial information which is necessary for making correct and timely management decisions. In this regard, information about income and expenses as the fundamental objects that form the organization's net assets is of particular interest. Income reports reflect basic information about the amount of resources raised and expenses incurred by non-commercial organizations.*

The purpose of this study is to study global practices in the disclosure of income and expenses in the financial statements of non-profit organizations, identify problems in domestic practices and explore ways to address these problems

Key words: *income, expenses, financial statements, income statement, non-profit organization*

JEL: M41.

1. Introduction

Organizations of the non-profit sector play a crucial role in the current modern reality providing socially significant services, thereby improving the quality of life in society. Huge financial flows from donors to non-profit organizations (hereinafter referred to as NPOs) require proper accounting and reporting.

Income and expenses accounting in non-profit organizations and their subsequent reflection in financial statements is the most controversial and debated topics worldwide. The widespread globalization of economic processes and the involvement of participants from different countries in the activities of NPOs (as a rule, donors from developed Western countries finance public and charitable events in third world countries) impose special requirements on the content and form of presentation of financial information which is necessary for making accurate and timely management decisions. This creates a need to unify accounting standards.

However, today there are no unified standards for NPOs. Taking into account national characteristics and tax legislation, each country has developed its own regulations governing accounting practices. This significantly complicates international cooperation by placing an additional burden on organizations – the preparation of "other" reports for foreign investors.

Unlike commercial organizations, the activities of NPOs are not aimed at making a profit. Their work is aimed at creating public goods and meeting social needs, often encountering unique situations and economic events. The issues of financial reporting of NPOs have been discussed worldwide for many years. These issues have been raised by academic researchers, standard-setters, stakeholders, and

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members of the NPO community including donors. Calls for standards to be developed specifically for NPOs are becoming increasingly urgent, especially given the diversity of existing NPOs — such as humanitarian aid organizations, educational institutions, healthcare organizations, religious organizations and others.

In this regard, information about income and expenses as fundamental objects that form the organization's net assets is of particular interest. The purpose of this study is to examine global practices in the disclosure of income and expenses in the financial statements of NPOs, identify problems in the practice of the Republic of Moldova (hereinafter-RM) and explore ways to address these problems.

Literature review

The presentation of high-quality, reliable and transparent information on income and expenses in the financial statements of NPOs largely determines the attractiveness of NPOs for donors and public confidence.

In this regard, an experiment conducted by Linda M. Parsons (2007) is very illustrative. In order to determine which information is crucial for donors' when making a decision to donate to NPOs, fundraising appeals containing various amounts of financial and non-financial information were sent to potential donors through the direct mail campaign. Logistic regression has shown that financial reporting can reduce the perceived uncertainty regarding the operating activities of NPOs, while disclosure of non-financial information has little influence on donation decisions.

Chinese researcher J. Chen (2021) emphasizes that financial reporting is the only way for NPOs to provide the public with information about their activities. People's willingness to donate directly depends on the reliability of these reports. As the quality of accounting information improves, trust in the organization and its transparency increases, which is important for the long-term development of charitable organizations.

Economist G. G. Yagudina (2012) notes that the absence of unified standards for NPOs forces donors to develop information submission forms and instructions for their completion independently, which do not contain clear guidelines. For this reason, these "unofficial" reports are most often falsified or presented with intentional or unintentional errors and inaccuracies.

In their work, Cordery, Belal, & Thomson (2019) consider financial statements as a significant accounting tool for NPOs which discloses information about the funds raised and the activities carried out. Their research revealed a contradiction between the regulated need to apply national financial reporting standards and the opinion of most users on the need to use international financial reporting standards. The analysis based on institutional logic shows that the existing financial statements are not sufficiently unified to meet the requirements of all interested parties

I. N. Mukhanova (2020) believes that in order to unify reporting for NPOs, it is worth paying attention to the American accounting standards for NPOs, the so-called FASB (Financial Accounting Standards Board), which has been developing and improving existing standards for more than 40 years. The concept of finance accounting is based on the works of American scientists such as A. Rn (1980) and his opponents E. Herzlinger and David H. Sherman (1980), who tried to explain the reasons for the collapse of many NPOs during the financial crisis in the 70s and find the best way to reflect economic events in financial statements.

A number of other scientists believe that "consideration of the financial accounting system in developed countries makes sense not only from the perspective of borrowing techniques, but also in order to avoid those mistakes that have already been made in the process of establishing accounting" (Хамидулина, Гусарова & Ягудина, 2008, p.6).

Moldavian economist A. Nederitsa (2015) notes that it is necessary to abandon the standardized form of income and expense reports and give each NPO the right to independently establish the structure of key positions in accordance with the information needs of users.

2. Basic content.

In accordance with the Law on Accounting and Financial Reporting No. 287/2017 (art.5, 2017), all subjects of the RM are required to submit financial reports. The general provisions for financial statements are outlined in the same Law (art.20, Law on Accounting and Financial Reporting No. 287/2017). Thus, financial statements prepared by entities of all organizational and legal forms in the RM must accurately present information about the financial position of the organization and the financial result of its activities. The information must be relevant, complete, unbiased, and error-free. In addition, financial statements should have the following qualitative characteristics that increase their usefulness: comparability, verifiability, timeliness and clarity.

According to the same Law (p.5 art. 5 Law on Accounting and Financial Reporting No. 287/2017), NPOs maintain double-entry accounting records and submit financial reports in accordance with the requirements outlined in the methodological guidelines on the specific accounting practices for NPOs developed by the Ministry of Finance (hereinafter referred to as the Methodological guidelines).

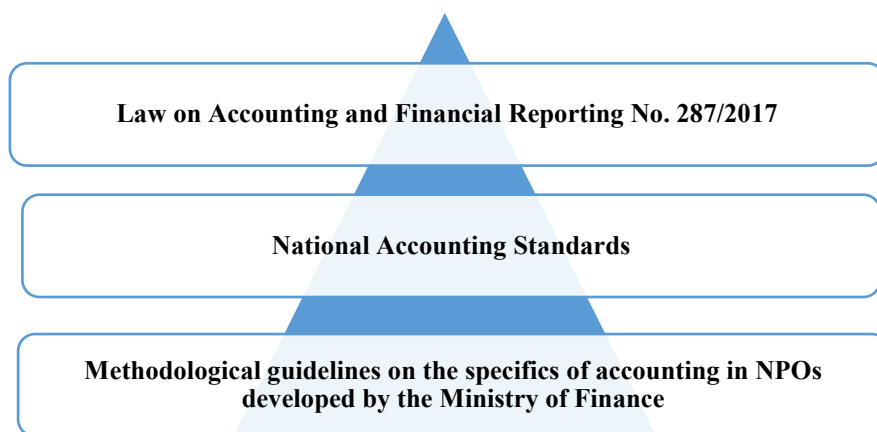


Figure 1. Regulatory framework governing the requirements for financial statements

Source: Compiled by the author

Methodological guidelines (p.81 Methodological guidelines, 2014), in turn, define the forms of financial statements, such as: the balance sheet, the income and expense statement, the statement of changes in sources of financing, and the explanatory note to financial statements.

Indicators of the income and expense statement are calculated based on the turnover of synthetic accounts for accounting for income (616, 617, and 618) and expenses (716, 717, 718, and 731) of NPOs (Недерица, 2024).

The income and expense statement, based on the Methodological guidelines, consists of the following elements:

- information on income;
- information on expenses.
- results of the NGO's statutory activities.

It is compiled according to the standard form provided in Appendix 2 to the Methodological guidelines and contains the following indicators:

Table 1. Income and Expense Statement indicators

Indicators	Page Code	Content
income related to targeted funds	010	amount of income recognized when using and writing off targeted funds
expenses related to targeted funds	020	amount of expenditure from targeted funds
surplus (deficit) related to targeted funds (p. 010 – p. 020)	030	surplus (deficit) may occur in the following cases: <ul style="list-style-type: none"> • when receiving valuables from writing off long-term tangible assets acquired/created from special targeted funds; • when recognizing expenses on disposal of long-term assets previously acquired/created from special targeted funds; • when reflecting the sale value of realized long-term assets related to the long-term asset fund
Other income (except for income from economic activities)	040	Amount of income from statutory activities, except for economic activities that do not relate to income from targeted funds
Other expenses (except for income from economic activities)	050	Amount of expenses in the course of statutory activities, other than economic activities that do not relate to expenditures from targeted funds
Surplus (deficit) related to other activities (p. 040 – p. 050)	060	Difference between other income and expenses (except for those received from economic activities)
Income from economic activities	070	Amount of income from economic activities
Expenses from economic activities	080	Amount of expenses from economic activities
Result: profit (loss) from economic activities (p. 070 – p. 080)	090	Difference between income and expenses from economic activities
Income tax expenses	100	Amount of income tax on taxable income determined according to the rules of tax legislation
Net surplus (net deficit) reporting period (p. 030+p. 060+p. 090–p. 100)	110	Result of the reporting period from the statutory activity of an NPO

Source: Compiled by the author based on sources (Methodological guidelines, 2014)

In accordance with Methodological guidelines (p.136, 2014), the amount of income related to target funds, is equal to or close in value to the amount of expenses incurred at the expense of these funds. A surplus(deficit) can only occur in certain situations. A report where income equals expenses is not informative. In this regard, users will be interested in a report on changes in funding sources which contains information on the balances and changes in target funds, non-target funds, deposits of founders and members, funds and other means of financing. In the practice of Western countries, this

report is combined with a report on income and expenses, which, in our opinion, is more practical and easier to understand.

The difficulty for accountants of NPOs that have concluded cooperation agreements with international organizations and others is that in addition to the officially approved form, it is necessary to prepare reports in accordance with the forms established by donors, grantees and other interested users of the income and expenses report. And here lies an important question: if NPOs in Moldova should adapt the existing forms to the requirements set by donors, or if it is still necessary to study world practices and propose a substantially new form, that would correspond, according to the Law, to the qualitative characteristic of financial information-comprehensibility, in other words, information should be classified, characterized and presented in an understandable form (Nederița, & Popovici, 2015).

"Reporting information in terms of content and form should be structured so that users can understand its nature and meaning. It is necessary that the form of reporting, document headings, names of indicators and concepts, accepted assumptions, classifications and groupings clearly reflect the essence of the issues, exclude possible ambiguous interpretations and do not contain unnecessary details" (Хамидулина et al., 2008, p.25).

Financial reporting in different countries has both common and specific characteristics. This is due to the national legal peculiarities of the country as well as the informational needs of users of such reports. For this reason, the form of presentation of these financial statements, its details and whether it reflects various aspects of the organization's activities are also different. Thus, the annual financial report may be considered satisfactory from the point of view of its full compliance with regulatory acts, but incomplete from the point of view of interested users.

The table below shows the forms of financial statements and the content of the income statement presented in the regulations of different countries.

Table 2. Financial reporting forms and content of income and expense statements

Regulatory act, year of adoption, withtran	Financial reporting Forms	Contents of the income and expense
Methodological Guidelines, 2014, RM	1) Balance sheet; 2) Income and Expense Statement; 3) Statement of Changes in sources of financing; 4) Explanatory note to financial statements	Income and expenses are reflected depending on the source of financing. The purpose of funds is defined: targeted, non-targeted, from economic activity.
SFAS 117, Financial Statements of Not-for-Profit Organizations, 1993, USA	1) Statement of Financial Position; 2) Statement of Activities; 3) Statement of Cash Flows	A statement of financial position provided by a not-for-profit organization shall report the amounts for each of three classes of net assets: permanently restricted net assets, temporarily restricted net assets, and unrestricted net assets - based on the existence or absence of donor-imposed restrictions.
ASU-2016-14, Accounting Standards Update, 2016, USA	1) Statement of Financial Position; 1) Statement of Activities; 2) Statement of Cash Flows	Three types of assets are replaced by two: Net Assets with Donor Restrictions and Net Assets without

		Donor Restrictions. The requirement to present expenses by function and type of expenses has been introduced.
SORP, Statements of Recommended Practice, United Kingdom	1) Statement of Financial Activities (SoFA); 2) Balance Sheet; 3) Statement of Cash Flows; 4) Statement explanatory note	The statement of financial activities (SoFA) is a single accounting statement that includes all income, gains, expenditure and losses recognised for the reporting period.
ANSPO, Accounting Standards for Non-for-Profit organization) Canada	1) Statement of Financial Position; 2) Statement of Operations; 3) Statement of Changes in Net Assets; 4) Statement of Cash Flows; 5) Notes	Income is recorded according to its type and limitations (limited, unlimited, and charitable contribution). Expenses are grouped into significant categories and can be classified by nature, by function, or program implemented.
IFR4NPOs (Draft International Financial Reporting Framework for NPOs)	1) Statement of Financial Position; 2) Statement of Income and Expenses; 3) Statement of Changes in Net Assets; 4) Statement of Cash Flows; 5) Notes to the Financial Statements	There is a recommendation that a NPO should produce a Statement on Income and Expenses, which leads to a surplus or deficit. The terms surplus/deficit appear instead of profit/loss.

Source: Compiled by the author based on sources

A study of scientific and specific legislation in a number of countries leads to the conclusion that financial statements contain various forms including the form in which information about income and expenses is presented. Based on the information provided, the following conclusions can be drawn:

1. Currently, the RM uses basically the same basic reporting forms as in international practice and consists of information on the financial position (balance sheet), a statement of economic activity (income and expense statement), and an explanatory note to financial statements. The report on changes in sources of financing is usually included in the report on the financial activities of an organization in the world practice, since it is impossible to reflect information on the attracted and used resources without information on the sources of targeted financing.

2. In the RM, the Methodological guidelines do not explicitly specify the composition of the income and expenditure groups of NPOs. According to the Methodological guidelines, the income statement provides information on the results of targeted, non-targeted, and economic activities. In the United States, the requirements for NPO reporting are set out in SFAS 117 with the ASU 2016-14 update. According to the American model, the ASU Activity Report 2016-14 provides data on how NPOs use their resources to implement various targeted programs related to their statutory activities. The greatest interest in forming such a report is caused by the requirements for disclosure of expenses. SFAS 117 requires the presentation of expenses by classifying them by functional value and dividing them into program and support activities. Updated ASUS 2016-14 require additional disclosure of expenditure and nature. NPOs independently choose which of the cost classifications to include in accounting" (Mukhanova, 2020, p.176). In comparison with Western forms of disclosure of information on income and expenses, the form presented in accordance with the Methodological guidelines, is not very informative.

3. In none of the standards presented above are the results of an organization's economic activity identified as a separate item. This is due to the fact that the resources attracted from economic activity are related to resources of a targeted or non-targeted (limited or unlimited) nature, depending on the decision made by the responsible persons. The presence of the result of economic activity in the Income Statement according to the Methodological Guidelines is due to the application of various standards for targeted (non-targeted) activities and economic activities, and the economic activities of NPOs in the RM are accounted for in accounting accounts in accordance with the generally established practice for commercial enterprises.

4. A distinctive feature of the income and expense statement, according to the Methodological Guidelines, is its strictly established form. In accounting practice in Western countries, there is usually no strictly defined form of activity report. Only the general structure and order of articles are defined. Therefore, the composition and structure of financial statements in Western countries is extremely diverse. They differ not only between companies from different countries, but also between enterprises in the same industry. However, despite this diversity, the fundamental understanding of financial reporting remains the same, and from this point of view, we can talk about some "general" forms of financial reporting (Хамидулина et al., 2008).

5. The strictly regulated form of financial reporting is a distinctive feature of financial reporting in the post-Soviet countries, since it is focused on meeting the information needs of state structures, especially in relation to taxation. In this regard, it should be mentioned that in addition to the financial statements in the RM, NPOs fill out an income tax Return for NPOs (Form ONG17), which was approved by the Order of the Ministry of Finance No. 08/2018. The ONG17 report provides for the adjustment of income and expenses received and used for other purposes, i.e. not in accordance with the statutory goals (Присакар, 2018). So with the announcement of Tax Code (art. 52 h.(2), 1997). NPOs of the RM are exempt from paying income tax, if special-purpose funds, other funds and income from statutory activities, property of the organization are used for the purposes provided for in the charter, regulations or other constituent document and do not use them in the interests of the founder or other interested person.

One of the functions of the Committee on International Financial Reporting Standards is to smooth out national differences by identifying the golden mean between the requirements of different countries legal systems, accounting standards and procedures related to the preparation and presentation of financial statements. To find the golden mean, IFR4NPO (International Financial Reporting Project for NPOs) highlights the following questions, the answer to which can help in developing the form and content of an activity report, that is useful for making management decisions:

1. *Reporting framework*: The format and content of financial statements, including income and expense information, are fundamental to how information is presented to stakeholders: The presentation form is especially important when revenue is restricted or can only be used for certain purposes.

Questions: How should financial statements be presented so that the user can understand the activities of NPOs? Should significant categories of income and expenses and / or operations be disclosed? How should unrestricted and restricted resources, which can be used for specific NGO purposes, be presented in the main financial reports and notes (including reserves)? How does this align with donor-imposed reporting requirements?

2. Classification of expenses: by functional value or by nature. NPOs can reflect information about expenditures by both nature, and functional significance.

Questions: Should there be a standardized format, and if so, what should be the primary headers? Should the primary cost analysis be based on functional significance or nature? (IFR4NPO, 2023).

3. Conclusions.

In conclusion, it is important to note that the problems of disclosing information about income and expenses are of concern to users of financial statements around the world. The world accounting practice has not yet presented unified solutions to these problems that would satisfy all participants in relationships within the framework of NPO's activities. The issue of the form and content of the income and expenditure report in the financial statements of NPOs is the main problem of the world scientific community. At this stage, the uniform form of financial reporting in the RM makes it difficult for donors and NPOs to communicate, making it more difficult for the latter to work. We believe that abandoning the standardized form of income and expense reports as well as the entire reporting process and giving NPOs the right to independently set the structure and composition of income and expense reports in accordance with the information needs of interested users will help solve this problem.

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