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30th July 2021

Dear Project Members of "International Financial Reporting for Non-Profit Organisations"

Comments on the Consultation Paper
Part 1: General NPO financial reporting issues

The Japanese Institute of Certified Public Accountants (hereafter "JICPA") highly respects International Financial Reporting for Non-Profit Organisations (hereafter "IFR4NPO") for its continuous effort to serve the public interest. We are also pleased to comment on the Consultation Paper (hereafter "CP") Part 1: General NPO financial reporting issues." Our comments to Part 1 of the CP are as follows.

Introduction

In Japan, financial statements prepared by not-for-profit organisations involve the issue that they differ largely depending on their legal entity forms, as social norms as to financial statements have been created based on laws and regulations applicable to each organisation. With not-for-profit organisations expanding their sphere of activities in society in recent years, the role of financial reporting has become increasingly important in helping stakeholders understand the activities of not-for-profit organisations. In light of this situation, we have advocated the need to establish an easy-to-understand accounting framework common across the not-for-profit sector. As part of this effort, we proposed an accounting framework in July 2019 by publishing the followings:

- Review of Financial Reporting for Not-for-Profit Organisations: Proposing Fundamental Concepts of Financial Reporting and Model Accounting Standards (hereafter the "Review Committee's Report")
- The Fundamental Concepts of Financial Reporting for Not-for-profit Organisations (hereafter the "Fundamental Concepts")
- The Model Accounting Standards for Not-for-profit Organisations (hereafter the "Model Accounting Standards")

Based on the Fundamental Concepts and the Model Accounting Standards, we are currently working to reduce the differences among not-for-profit organisations incorporated in different forms through continuous communication with stakeholders of not-for-profit organisations.

We do not necessarily share the same interests but do share some of the issues we have with the IFR4NPO project, thus, we will comment on areas where our experience may contribute to the IFR4NPO project. The focus of our comments is on the differences between the proposals presented in our efforts and those in the CP, and the background of our proposals. We have attached the Review Committee's Report for reference.

We hope that our comments will contribute to future discussions under the IFR4NPO project.

General Matters for Comment 1.a – Chapter 1

Do you agree with the broad characteristics proposed in Chapter 1 for describing NPOs? If not, why not? Which alternative characteristics would you propose, and why?

Comment:

We have not compared a broad characteristic approach with a statistical framework approach using economic statistic for describing not-for-profit organisations as the CP does. Instead, we considered the characteristics of the organisations targeted by the Model Accounting Standards in a manner similar to the CP's broad characteristic approach, without using legal entity form as an identifying factor. In our consideration, we focused on organisational objectives and identified "whether or not the organisation aims to provide economic benefits to resource providers," as an important characteristic that differentiates for-profit and not-for-profit organisations. We also agree with the CP on another characteristic of not-for-profit organisations: "the organisation's profits/surpluses are directed for public benefit." We advanced discussions as follows based on our stance above.

The Fundamental Concepts assume that in not-for-profit organisations, financial resources accumulated through business activities are used to achieve their organisational objectives. The legal system in Japan also generally imposes certain restrictions on the distribution of accumulated financial resources, or surplus, to resource providers by corporations positioned as not-for-profit organisations. On the other hand, in limited circumstances, some corporations may be allowed to distribute surplus in the form of dividends or distributions, etc., or to return residual assets including surplus monies to resource providers, in accordance with the contribution ratio, etc. upon the appropriation of residual assets (that is, when the resource provider reserves the right to claim the residual assets). With regard to payments to resource providers, if the payment is in effect merely a refund of contributed assets, it is not considered the provision of economic benefits to the resource provider. On the other hand, in some cases, it may be possible to distribute surplus, or financial resources earned through organisational activities. In such cases, as a basis for classifying the organisation as a not-for-profit organisation, we have decided to determine whether they are intended to provide economic benefits to resource providers, by taking into account the size of such economic benefits to be enjoyed by and the risks to be borne by the resource providers, as well as whether the resource providers expect to receive economic benefits in return for the resources they provide. If such intention by the organisation distributing surplus is not recognised, we categorize the organisation as a not-for-profit organisation (Please refer to Paragraphs 15 through 17 of the Fundamental Concepts below.)

(Excerpt from the Fundamental Concepts)

15. In not-for-profit organisations, financial resources accumulated through business activities are expected to be used to achieve their organisational objectives. The legal system in Japan also generally imposes certain restrictions on the distribution of accumulated financial resources, or surplus, to resource providers by corporations positioned as not-for-profit organisations.

16. On the other hand, in some cases, some corporations are allowed to distribute surplus in the form of dividends or distributions, etc. or to return residual assets including surplus monies to resource providers, in accordance with the contribution ratio, etc. upon the appropriation of residual assets (that is, when the resource provider reserves the right to claim the residual assets).

17. With regard to payments to resource providers, if the payment is in effect merely a refund of contributed assets, it is not considered the provision of economic benefits to the resource provider. On the other hand, in some cases, it may be possible to distribute surplus, or financial resources earned through organisational activities. In such cases, as a basis for classifying the organisation as a not-for-profit organisation, we have decided to determine whether they are intended to provide economic benefits to resource providers, by taking into account the size of such economic benefits to be enjoyed by and the risks to be borne by the resource providers, as well as whether the resource providers expect to receive economic benefits in return for the resources they provide.

General Matters for Comment 2.a – Chapter 2

Do you agree that NPOs are accountable to service users, resource providers, and regulators and have societal accountability? If not, why not? What alternative groups would you propose NPOs can be accountable to, and why?

Comment:

Since assumed stakeholders and their information needs are important factors in the development of financial reporting, we discussed them as a starting point for our efforts.

The Fundamental Concepts assume various stakeholders as the main stakeholders of not-for-profit organisations, including resource providers, creditors, beneficiaries, employees, volunteers, and local residents. Regulators, which are explicitly identified as stakeholders in the CP, are generally positioned as important stakeholders because they, acting as competent authorities, can directly require not-for-profit organisations to provide financial reports, and the reporting of financial information is required by law for administrative purposes. However, since our efforts are focused on general purpose financial reporting to meet the information needs of users who are unable to require the preparation of financial reports tailored to meet their specific information need, we position regulators lower than other stakeholders in terms of the priority of stakeholders. Among the main stakeholders, we have positioned resource providers and creditors as the main information users, and therefore focused on constructing a financial reporting model that meets their information needs. (Please refer to Paragraph 4, and Paragraphs 19 through 21 of the Fundamental Concepts below.)

(Excerpt from the Fundamental Concepts)

4. General purpose financial reporting constitutes the core of transparent financial reporting by not-for-profit organisations. General purpose financial reports are intended to meet the information needs of users who are unable to require the preparation of financial reports tailored to meet their specific information needs.

19. Not-for-profit organisations have various stakeholders, including resource providers, creditors, beneficiaries, employees and volunteers, and local residents. Each stakeholder has the following expectations.

Main Stakeholders' Expectations of Not-for-profit Organisations

Resource providers:

Resource providers provide resources necessary for activities by not-for-profit organisations to achieve their objectives. Resource providers in this context include members, donors, grant and subsidy providers, and, more broadly, taxpayers.

Resource providers expect not-for-profit organisations to deliver social services and achieve positive results towards solving problems by serving public interest or engaging in activities that contribute to public interest under their purposes.

Creditors:

Creditors are those who have a claim against a not-for-profit organisation through financial or commercial transactions. They are interested in ensuring that claims are collected. In addition, creditors presumably are also interested in the certainty of stable and reliable transactions with not-for-profit organisations from the perspective of their business partners.

Beneficiaries:

Beneficiaries are those who receive services provided by not-for-profit organisations, and their attributes vary depending on the activities of the organisation, such as welfare service users, students, and patients.

Beneficiaries who receive services from not-for-profit organisations expect continuous and high-quality services to be provided in the future.

Employees and volunteers

Not-for-profit organisations often employ employees for their organisational activities. Employees expect to be engaged in challenging work, to achieve social objectives, to be compensated fairly for their work, to have continued employment, and to have better working conditions. In addition, volunteers who support the activities of not-for-profit organisations from a practical standpoint are also important stakeholders, and they expect to be engaged in challenging work and achieve social objectives.

Local residents:

Local residents expect not-for-profit organisations to contribute to, and have a smooth relationship with, the community from a wide range of perspectives, including the continuous provision of public services and employment.

20. We have witnessed a growing demand from society for establishing a financial reporting framework that meets the needs of diverse stakeholders in a balanced manner. However, if a financial reporting framework is constructed in such a manner, it will lead to the problem that the volume of information to be provided could be enormous and financial statements could be too complicated.

21. From the perspective of the usefulness and cost-effectiveness of financial reporting, we believe we should focus on important information needs of stakeholders. Based on this, the Fundamental Concepts and the Model Accounting Standards focus on constructing a financial reporting model that meets the need of resource providers and creditors, whom we have positioned as the main information users of the financial reporting of not-for-profit organisations. Resource providers here include not only direct resource providers

such as donors, grant and subsidy providers, but also indirect resource providers such as taxpayers who indirectly provide financial resources through paying taxes to the government. We focus on the information needs of resource providers and creditors not because we believe that the needs of other stakeholders should be neglected, but rather we believe that constructing a consistent financial reporting model that takes into the needs of such a wide range of resource providers and creditors will lead to the preparation of financial reports that meet the diverse needs of other stakeholders.

General Matters for Comment 2.b – Chapter 2

Do you agree that external stakeholders require information on an NPO's achievement of objectives, economy efficiency and effectiveness compliance with restrictions and regulations, and longer-term financial health, for accountability and decision-making purposes? If not, why not? What alternative areas would you propose and why?

Comment:

The Fundamental Concepts state that from the perspective of providing information useful for decision-making, information about the capacity to continue activities and the activities of the organisation (services provided and their effectiveness and efficiency) is necessary. From the viewpoint of accountability based on stewardship, it is important that the resources provided are used in line with the purposes of resource providers, besides the provision of information about the activities of the organisation. Therefore, the CP and the Fundamental Concepts do not differ significantly as to the identification of stakeholders' information needs but differ in the way they are sorted out. Specifically, while the CP presents the information needs of stakeholders in a flat manner, the Fundamental Concepts sort them out based on the objectives of financial reporting, as they are the starting point of discussions in the structure of the Concepts. In addition, the Fundamental Concepts do not explicitly state an NPO's compliance with regulations as presented in the latter part of Paragraph 2.16, Chapter 2 of the CP. (Please refer to Paragraphs 24 through 26 of the Fundamental Concepts below.)

(Excerpt from the Fundamental Concepts)

24. From the perspective of providing information useful for decision-making, information about the capacity to continue activities and the activities of the organisation (services provided and their effectiveness and efficiency) is necessary. Of these, information about the capacity to continue activities consists of various aspects such as finance, human resources, experience, and facilities, which indicates the existence of an organisational infrastructure for providing services on an ongoing basis. Information on organisational activities consists of information on organisational purposes, activity plans, and activity

results. In addition, information on activity plans and results can be broken down into information on the organisation's efforts through its activities (acquisition and allocation of resources) and information on activity results.

25. On the other hand, from the viewpoint of accountability based on stewardship, the important information is whether the resources provided are used in line with the purposes of resource providers, besides the information about the activities of the organisation as described in the previous paragraph. Not-for-profit organisations, therefore, must fulfil information needs as to whether the resources provided are used appropriately, especially in a manner conforming to or consistent with specified uses.

26. As described above, the objectives of financial reporting, which are the provision of information useful for decision-making and fulfilment of accountability based on stewardship, correspond to three information needs: 1) the capacity to continue activities, 2) organisational activities, and 3) the consistency with the purposes of resource providers. In order to meet these information needs, the financial reporting of not-for-profit organisations should include the organisation's economic resources, liabilities, and net assets ("stock approach" based information), activity results ("flow approach" based information), and cash flows. In addition, in order to meet the information needs of (3) the consistency with the purposes of resource providers, it is important to provide information on resources with restricted use in relation to "stock approach" based and "flow approach" information.

General Matters for Comment 2.c – Chapter 2

Do you agree with the issues that have been identified with current accountability and decision-making arrangements for NPOs? If not, why not? Are there any other issues with current accountability and decision-making arrangements, particularly financial accountability to donors, that you would wish to highlight?

Comment:

As stated in the Review Committee's Report, in terms of the types of operations and stakeholders, the distinctions between not-for-profit organisations incorporated in different forms have recently been narrowing, or even have been overlapping, thus, we recognise the need to bring accounting standards that are different from legal entity form to form closer together. In this regard, we recognise the issue that is similar to the second issue described in Paragraph 2.23, Chapter 2 of the CP and are working to resolve it.

On the other hand, the first and third issues in Paragraph 2.23, Chapter 2 of the CP, namely, the issues caused by the fact that reporting requirements vary depending on jurisdictions, are not considered to be urgent and important issues to be addressed because, unlike the CP, the Model Accounting Standards mainly target organisations operating and based in Japan. (Please refer to Chapter 1 Background and Purpose of the Review, 2. Current Status and Issues of Not-for-Profit Organisation Accounting Standards in the Review Committee's Report.)

General Matters for Comment 5.a – Chapter 5

What do you see as the main challenges, if any, with the proposed Guidance model and the use of the IFRS for SMEs Standard as the foundational framework? What, if any, alternative model and/or foundational framework do you suggest would be more suitable and why?

Comment:

In Paragraph 5.17 through 5.19, Chapter 5 of the CP, the CP assumes the same reporting framework will be applied irrespective of type or size of the organisation.

In this regard, as stated Chapter 3 Issues and the Conclusion, 3. Target Organisations in the Review Committee's Report, in principle, we present the Future Vision of accounting that should be applied to all not-for-profit organisations. However, we also suggest the possibility of establishing a simplified treatment, separately from the fundamental accounting standards. This is because smaller organisations are considered to have more restrictions than larger ones in terms of accounting practices and costs. Therefore, in contrast to the CP' stance above, we consider the possibility of setting different accounting standards according to organisation's size. (Please refer to Chapter 3 Issues and the Conclusion, 3. Scope of Not-for Profit Organizations (2) Small organisations in the Review Committee's Report.)

Yours sincerely,

Shuichiro Akiyama
Executive Board Member - Not-for-profit Organizations
The Japanese Institute of Certified Public Accountants

Report of the Not-for-Profit Organization Accounting Committee

Review of Financial Reporting for Not-for-Profit Organizations:
Proposing Fundamental Concepts of Financial Reporting and Model Accounting Standards

July 18, 2019
The Japanese Institute of Certified Public Accountants

Contents

This document is a provisional translation of a report previously published by JICPA and serves as a reference material for our comments. It does not constitute an official document of JICPA.

Introduction

The Japanese Institute of Certified Public Accountants (hereinafter “JICPA”) has advocated the need to establish an accounting framework that is commonly applicable to the private not-for-profit sector and understandable for general audience of the accounts. This was based on the awareness of the problem that, while expectations for not-for-profit organizations are growing and their sphere of activities is expanding, the social norms as to financial statements and the accounting practices used in preparing financial statements differ largely depending on their legal entity forms, thus, impairing the convenience of the users of financial information in Japan. This is because such social norms are created based on laws and regulations applicable to each of the legal entity forms.

Our vision for the future of the not-for-profit organization accounting in Japan is to realize an environment in which persons with basic knowledge of accounting can easily understand the financial position, activities, and the use of resources of not-for-profit organizations through the financial statements, regardless of their forms of legal entity. To achieve this vision, we need to ensure that not-for-profit accounting meets the needs of general purpose by creating a consistent and easy-to-understand framework that meets the needs of the general users of financial information and sharing it with stakeholders across not-for-profit sector. It is essential to develop the norms as the foundation for preparation of financial statements under a concise and clear system.

This report proposes a framework of not-for-profit organization financial reporting as the results of our discussion to wider public. It covers the “Fundamental Concepts of Financial Reporting” and the “Model Accounting Standards”. We would be happy if the proposal serves as the first step in forming a cross-sectoral platform for financial reporting for not-for-profit organizations.

<List of Members of the Not-for-Profit Organization Accounting Committee >

Kazuo Aida (Professor Emeritus, Keio University)
Shuichiro Akiyama (Executive Board Member, JICPA / Ernst & Young ShinNihon LLC)
Hideki Fujii (Professor, Graduate School of Economics, Kyoto University)
Takashi Hashimoto (Professor, Graduate School of Professional Accountancy, Aoyama Gakuin University)
Atsushi Itabashi (Director, Accounting Standards Board of Japan)
Ineko Iwashita (Deloitte Touche Tohmatsu LLC)
Toru Kajikawa (Chairman, Public Accounting Council, JICPA / Grant Thornton Taiyo LLC)
Noriyuki Moriya (KPMG AZSA LLC)
Takeshi Shiba (Executive Board Member, JICPA/ PricewaterhouseCoopers Arata LLC)
Hiroshi Shiina (Executive Board Member, JICPA/ KPMG AZSA LLC)
Masashige Takayama (Kyowa Audit Corporation)
Kazuo Wada (Wada Certified Public Accountant)
Haruhiko Yamada (Deputy President, JICPA)

* In alphabetical order, honorifics omitted

Chapter 1 Background and Purpose of the Review

1. Rationale of Financial Reporting for Not-for-Profit Organizations

In recent years, the private sector has been increasingly expected to take on a greater role in solving social welfare and other social issues. Among the private sector, such expectations are particularly high for not-for-profit organizations. In Japan, not-for-profit organizations can be established in various forms of legal entity[1], such as public interest corporations, specified nonprofit corporations, social welfare corporations, medical corporations, and Incorporated Educational Institutions, which have already played important roles. These roles, however, are expanding further as they become the direct providers of diverse values by, for example, providing social services through autonomous and creative private initiatives or making policy proposals. In order for these not-for-profit organizations to meet society's expectations going forward, they need to enhance their independence and management capacity.

In the first place, any organization, whether for profit or not, has a fiduciary responsibility to resource providers and creditors. Therefore, they have to fulfill their accountability to stakeholders by preparing appropriate financial reports. In addition, in order to fulfill social responsibilities, promote sustainable management, and thereby achieve their objectives, they need to establish a financial governance. Although the degrees of responsibilities and the strictness levels of the discipline required vary depending on the size and stakeholder structure of the organization, the fact remains that accountability and financial governance are required of all organizations. In addition, by fulfilling these requirements, an organization is able to enhance its credibility, and thereby build a foundation for securing financial and other resources (including funds and human resources) which are essential to its operation.

Given the growing expectations for not-for-profit organizations from society and based on these assumptions, as mentioned above, the following three points should be taken into account in reviewing the future vision of financial reporting for not-for-profit organizations:

(1) Necessity of financial independence and autonomy of management

First, not-for-profit organizations are increasingly required to strategically raise funds for their operations on their own. In Japan, the fundraising sources for not-for-profit organizations traditionally include support funds, such as subsidies and public subsidy for social welfare treatment Previously, these accounted for a large proportion of their fundraising, but it is considered important today to increase the fundraising from the private sector, as the proportion of support funds has been shrinking. In the social welfare system reform in recent years, social welfare corporations were requested to enhance their financial governance and external accountability. The reform, thus, has made it more important for not-for-profit organizations to enhance their financial management and external information disclosure than ever before.

(2) Request for establishing organizational governance

Second, not-for-profit organizations also are increasingly requested to establish governance. Unlike for-profit corporation, not-for-profit organizations have no equity holders such as shareholders. Not-for-profit organizations, therefore, need to realize sound management and achieve organizational objectives while accommodating the needs of various stakeholders such as beneficiaries, resource providers, creditors, employees, local communities, and governments. While not-for-profit organizations should establish a system to supervise the organizations, it is important that they grasp and report on their financial position and results in an appropriate manner to ensure that the Board of Trustees and the Board of Directors fulfill their supervisory functions.

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[1] Not-for-profit organizations in this report include a broad range of organizations that are not incorporated. In Japan, since the accounting standards for not-for-profit organizations vary depending on their legal entity forms and based on applicable laws and regulations, we call these organizations as corporations when focusing on the differences among them due to legal entity forms.

(3) Reducing distinctions in operations and stakeholders between organizations incorporated in different legal forms

Third, in terms of the types of operations and stakeholders, the distinctions between organizations incorporated in different legal forms have recently been narrowing, or even have been overlapping. Recently, corporations operating hospital business include not only medical corporations and social welfare corporations but also Incorporated Educational Institutions and public interest incorporated foundations. The forms of legal entity that are able to operate nursing care business also range widely, from social welfare corporations and medical corporations to specified nonprofit corporations. In fact, an increasing number of specified nonprofit corporations have actually positioned the nursing care business as their main business. Further, besides Incorporated Educational Institutions, corporations of other forms such as specified nonprofit corporations have entered the educational business as operating entities. With respect to support-type not-for-profit businesses (i.e. public welfare undertakings), social welfare corporations are now required to implement "charitable activities for local communities" under the Social Welfare Act which was amended in 2016 following the enactment of a law to partially amend acts including the Social Welfare Act. Under these circumstances, more not-for-profit organizations, irrespective of their legal entity formats, are engaged in similar businesses, and as a result, the stakeholders of these organizations have tended to overlap. Thus, financial reporting has become more important than ever before for not-for-profit organizations in obtaining resources from broader sources, enhancing their management capacity, and establishing organizational governance, all on their own. Moreover, given that distinctions between organizations incorporated in different legal forms are getting smaller, it is important to build a cross-sectoral platform for financial reporting for not-for-profit organizations regardless of their forms of legal entity.

2. Current Status and Issues of Not-for-Profit Organization Accounting Standards

In Japan, not-for-profit organizations historically have relied on accounting standards that were developed independently from accounting standards for for-profit corporations. The accounting standards applicable to not-for-profit organizations and the bodies that set such standards are different from legal entity form to form. In recent years, differences in accounting treatment and presentation between not-for-profit organizations have narrowed through revisions to their accounting standards. This issue, however, has yet to be fundamentally resolved as the differences are still material, making it difficult to understand the financial statements of not-for-profit organizations of other legal entity forms even for those operating the same kind of business.

In addition, although the users of financial statements need to understand the accounting standards that form the foundation for preparing financial statements of an organization, we have found it difficult to expect that stakeholders of not-for-profit organizations have specialized knowledge of multiple accounting standards. We would say the situation in which accounting standards vary depending on the legal entity form has significantly impaired the convenience of users of financial information.

Against the backdrop of such differences in accounting standards between not-for-profit organizations seems to be the fact that each accounting standard was set and revised by each competent authority, and that until recently, the emphasis was placed on the convenience of competent authorities in managing and supervising the standards rather than the needs of the general users of financial information.

In an era where distinctions in operations and stakeholders between organizations incorporated in different legal forms are narrowing, and the needs for coordination between these organizations are growing, we need to bring different accounting standards and practices closer together. For not-for-profit organizations to meet the needs of stakeholders such as resource providers and creditors, they need to build a cross-organizational accounting framework for not-for-profit organizations regardless of their forms of legal entity.

3. Future Vision of Financial Reporting for Not-for-Profit Organizations

To meet the needs of general users of financial information, we need to build a consistent and easy-to-understand financial reporting model under a framework that is commonly applicable to all forms of not-for-profit organizations. To this end, accounting standards must be established based on the fundamental questions of for whom and what purposes accounting is designed and what kind of information is required. In addition, such efforts must reflect the basic characteristics common to all not-for-profit organizations. At the same time, the accounting of not-for-profit organizations that provide a particularly important public utility must go beyond simply disclosing the information necessary for government authorities to carry out legally required guidance and supervision. This accounting must also fulfill a role as social infrastructure by guaranteeing the financial soundness of such organizations. Meeting specific specialized needs like these while simultaneously meeting the needs of the general users of financial information is another important lens through which to consider the accounting of not-for-profit organizations.

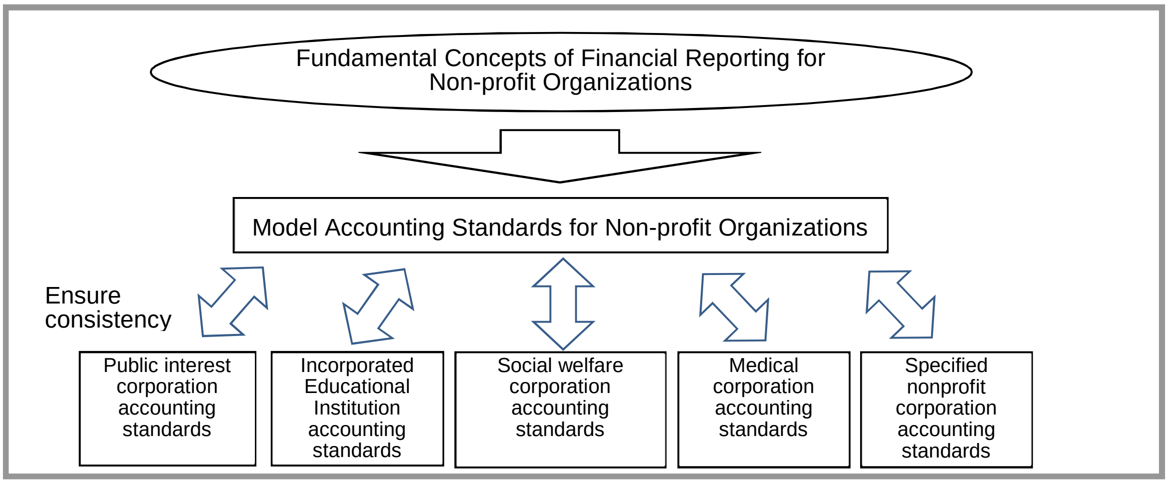
4. Approach to increasing commonality of financial reporting across legal entity forms

We believe one of the approaches to eliminating distinctions between not-for-profit organizations incorporated in different legal forms and realize an easy-to-understand and consistent not-for-profit organization accounting in Japan is to consolidate several different accounting standards. However, consolidating multiple accounting standards in the short term will likely cause many major changes to the existing accounting standards adopted in each legal entity form. In such cases, it is also concerned that the workload on not-for-profit organizations, which are the preparers of financial statements, will be material as they have to adapt to these changes.

In view of smoothly implementing practical measures and avoiding excessive workload, sufficient consideration must be given as to the continuity of accounting standards. Specifically, we can make the changes gradual by taking into sufficient consideration the continuity of the current system and practices, while making it a basic policy to increase the commonality of accounting standards. In 2013, JICPA published Not-for-Profit Organization Accounting and Audit Practice Committee's Research Report No.25 titled “Toward Establishing an Accounting Framework for Not-for-Profit Organizations” (hereinafter the “Research Report No. 25”), thereby working out the fundamental concepts for financial reporting of not-for-profit organizations and proposing an approach to developing Model Accounting Standards for Not-for-Profit Organizations based on these concepts.

The first step of this approach is to identify the characteristics of the not-for-profit organization, the purposes of their financial reporting, the needs of the users of financial information, etc., and document the Concepts of Financial Reporting that are common across not-for-profit organizations. On top of this, we will work out the basic accounting treatment of not-for-profit organizations and build Model Accounting Standards, while ensuring consistency with existing accounting practices. Model Accounting Standards do not represent the standards for accounting treatment and presentation that should be applied to individual legal entity forms, but are intended to be referenced when institutional accounting standards are developed or revised. We expect the consistency between standards will increase through sharing of the Fundamental Concepts of Financial Reporting in not-for-profit organizations, as well as revisions based on Model Accounting Standards that provide more concreate standards as to accounting treatment. [Figure 1]

Figure 1: Illustrative diagram of the Model Accounting Standards

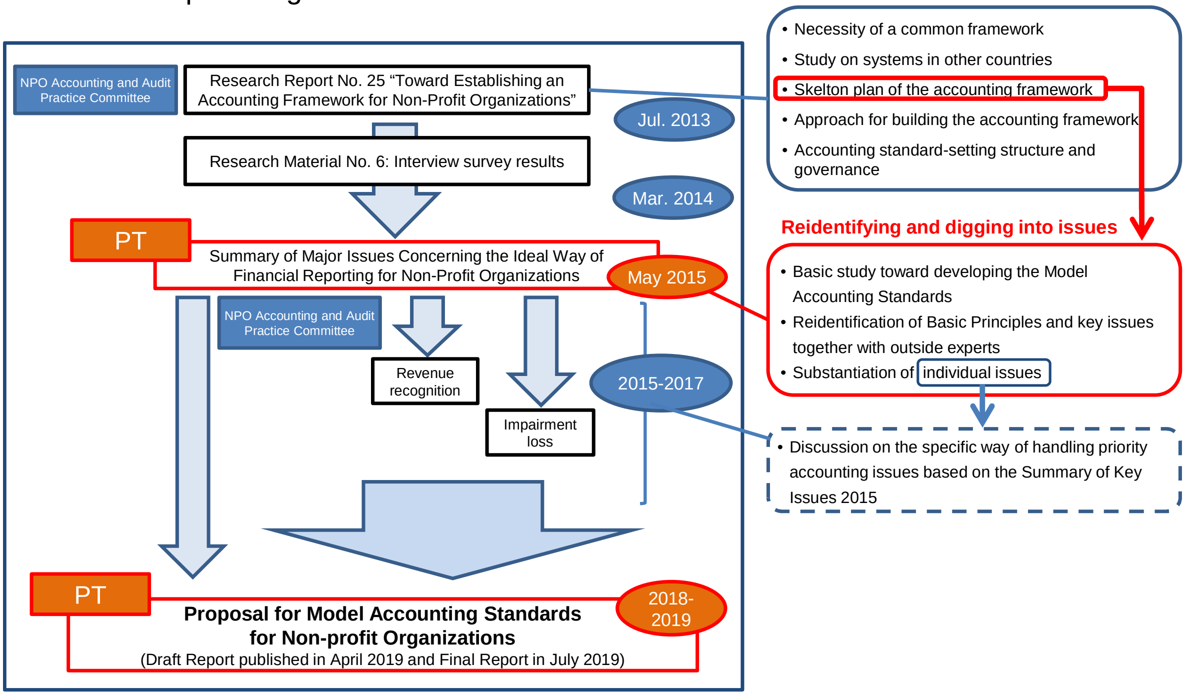


These are selected accounting standards for not-for-profit organizations incorporated in different legal forms, which are not limited only to the above.

5. Proposal on Fundamental Concepts of Financial Reporting and Model Accounting Standards for Not-for-Profit Organizations

Based on the results of our discussion described in Research Report No. 25, JICPA has continued to review the Fundamental Concepts of Financial Reporting for Not-for-Profit Organizations and key issues in accounting. Specifically, we established Not-for-Profit Organization Accounting Committee (a project team), participated by outside experts who have specialized knowledge and insight in this field. We also published the report of the Committee titled “Summary of Major Issues Concerning the Future Vision of Financial Reporting for Not-for-Profit Organizations.” (hereinafter, the “Summary of Key Issues”). In addition, the Not-for-Profit Organization Accounting and Audit Practice Committee (the Expert Committee on Not-for-Profit Accounting Review) reviewed the issues that were deemed particularly important in consideration of practical measures, and compiled the results into a research report.

Figure 2: Prehistory of JICPA's review on the cross-sectoral accounting framework for not-for-profit organizations



In view of the growing need to increase the commonality of financial reporting in not-for-profit organizations, we have decided to develop the Fundamental Concepts of Financial Reporting for Not-for-Profit Organizations (hereinafter the "Fundamental Concepts of Financial Reporting") and Model Accounting Standards for Not-for-Profit Organizations (hereinafter the "Model Accounting Standards") and propose them to broader society.

Supplementary materials 1: Fundamental Concepts of Financial Reporting for Not-for-Profit Organizations
Supplementary materials 2: Model Accounting Standards for Not-for-Profit Organizations

In reviewing the framework, we focused particularly on the following four points, based on the results of discussions so far:

1) Whether it meets the expectations of the users of financial information

   Information disclosed must meet the needs of the stakeholders who use it.

2) Whether it reflects the characteristics inherent to not-for-profit organizations

   Financial statements represent the financial position, etc. of an organization that have prepared them. Therefore, the accounting of a not-for-profit organization must reflect the characteristics inherent to each not-for-profit organization.

3) Whether it is consistent across the not-for-profit sector

   In the accounting for external reporting purposes, the users of financial information will not be able to understand appropriately the earnings results and will find it difficult to compare the results between organizations unless they are prepared under a common framework. Even if the legal entity forms are different, it is important to ensure consistency across the not-for-profit sector by securing the mutual consistency in accounting treatment and presentation when the comparison between organizations is likely as their user base overlaps or they operate the same kind of business.

4) Whether the accounting information is easy to understand for the general users of financial information

   In order for many stakeholders to use accounting information disclosed for decision-making, the information should be easy to understand and highly convenient.

Chapter 2 Review Structure and Process

In reviewing the Fundamental Concepts of Financial Reporting and Model Accounting Standards, JICPA established the Not-for-Profit Organization Accounting Committee. The Committee is a project team consisting of academics and business professionals (certified public accountants) with specialized knowledge of not-for-profit organization accounting.

For creating this report, the Committee held a total of eight meetings as shown in the table below. In addition, a series of working group meetings were held for detailed review.

Figure 3: Review Schedule

	Year/month	Topics	Key issues
1st	June 2018	・ Purpose of setting the Model Accounting Standards and agreement on directionality ・ Review of the Fundamental Concepts	・ Scope of application ・ Structure of table of contents, fundamental idea ・ Framework (qualitative characteristics)
2nd	August 2018	Individual issues: (1) System of, and recognition and measurement financial statements	・ System of financial statements, name of each statement ・ Restricted/unrestricted classification of net assets, and notes
3rd	October 2018	Individual issues: (2) Recognition and measurement	・ Assets (including leases and monetary claims) ・ Liabilities (including retirement benefits, asset retirement, and tax effect)
4th	December 2018	Individual issues: (3) Recognition and measurement, disclosure, and presentation	・ Earnings (earnings with repayment or economic benefits proportionate to resource provided) ・ Cost accounting ・ Necessary notes
5th	January 2019	Proposed Overall Model Accounting Standards (1)	・ Review of the overall proposal
6th	March 2019	Proposed Overall Model Accounting Standards (2)	・ Review of the overall proposal
7th	April 2019	Proposed Overall Model Accounting Standards (3)	・ Documentation of Draft Model Accounting Standards
8th	July 2019	Final Proposed Model Accounting Standards	・ Review of opinions on Draft Model Accounting Standards ・ Documentation of Final Draft Model Accounting Standards

In order to reflect the views of a wide range of stakeholders involved in not-for-profit organization accounting, we solicited opinions from them for a month after publication of the report. Based on the opinions received, the project team reviewed the draft, made necessary corrections, and published it as a final report.

Chapter 3 Issues and the Conclusion

This chapter discusses the issues and the conclusion of the Fundamental Concepts of Financial Reporting and Model Accounting Standards.

1. Role of Model Accounting Standards

Each corporation prepares its financial statements in accordance with the accounting standards required by relevant laws and regulations that are applicable to each legal entity form of not-for-profit organizations. The Model Accounting Standards proposed in this report are expected to increase the consistency between multiple accounting standards applicable to corporations that fall under not-for-profit organizations and enable these organizations to achieve the objectives of financial reporting.

The Model Accounting Standards are positioned as a framework for Model Accounting Standards applicable to legal entities that fall under not-for-profit organizations. By presenting accounting standards as a model of financial reporting for not-for-profit organizations, we can expect that the consistency between their standards will be enhanced through the process in which the model is referenced when accounting standards for each legal entity form are revised.

2. Relationship with Accounting Standards for For-Profit Corporations

With a view to establishing, both practically and formally, a coherent framework for achieving the objectives of financial reporting for the private not-for-profit sector, and ensuring consistent application of accounting standards by not-for-profit organizations by clearly defining the scope of standards, we have adopted an approach to documenting the Fundamental Concepts of Financial Reporting and Model Accounting Standards independently of the accounting framework for for-profit corporations so that they are well-established and complete on their own.

In reviewing individual issues as to the Fundamental Concepts of Financial Reporting, recognition and presentation, we took into consideration the consistency with accounting for for-profit corporations, while focusing on reflecting the objectives of financial reporting for and organizational characteristics of not-for-profit organizations.

Therefore, the same recognition and measurement method as that for accounting for for-profit corporations is adopted in cases where the objectives of financial reporting and the organizational characteristics do not differ from those of profit-earning corporations, and thus, the method is free from the influence of such differences.

3. Scope of Not-for Profit Organizations

(1) Scope of application

Model Accounting Standards are intended for private not-for-profit organizations. Accordingly, for-profit corporations, as well as economic entities belonging to the public sector (including governments, municipalities, independent administrative agencies, and other government agencies) are not included in the scope of not-for profit organizations. In addition, while group information has become increasingly important for not-for-profit organizations, we have many issues to be discussed separately as to the scope of organizations in a group in the not-for-profit sector and the future vision of providing group information, we have decided to discuss these issues later. Therefore, the scope of not-for profit organizations in this discussion are limited to individual corporations.

(2) Small organizations

The Model Accounting Standards do not take into account differences in organizational size. It presents the future vision of accounting that should be applied to all not-for-profit organizations, regardless of their sizes.

On the other hand, it is also true that smaller organizations have more restrictions than larger ones in terms of accounting practices and costs. To deal with this issue, it is desirable to establish a simplified but detailed accounting treatment for smaller organizations that is viable on its own, separately from the accounting standards that provide for fundamental accounting procedures.

4. Fundamental Concepts of Financial Reporting

(1) Fundamental Concepts of Financial Reporting and Model Accounting Standards

In developing the Model Accounting Standards, we reviewed the concepts that underlie the Fundamental Concepts of Financial Reporting, including the organizational characteristics of not-for-profit organizations, the objectives of financial reporting, the qualitative characteristics of useful financial information, the elements of financial statements, and such accounting concepts as recognition and measurement, and then summarized them into the "Fundamental Concepts of Financial Reporting for Not-for-Profit Organizations." The Fundamental Concepts of Financial Reporting serve as the basic guidelines for developing accounting standards, which allow not-for-profit organizations to develop accounting standards based on a consistent philosophy and achieve the objectives of financial reporting under a clear framework. In addition, by documenting the Fundamental Concepts and sharing them among the general public, we can help the preparers of financial statements and the users of financial information to understand the philosophy underlying accounting and thereby contribute to facilitating the interpretation of accounting standards and understand financial statements prepared.

(2) Organizational objectives of not-for-profit organizations

In taking into consideration the organizational characteristics of not-for-profit organizations, we focused on their organizational objectives. This is because the objectives of the organizations are inextricably linked to the objectives of resource providers, and thus, affect the objectives of financial reporting and the needs of the users of financial information, which are integral part of the Fundamental Concepts of Financial Reporting,.

Not-for-profit organizations are intended to contribute to public interest or common benefit through their organizational activities. Not-for-profit organizations differ from profit-earning organizations in that resource providers do not expect economic benefits in return from the organization for the resources they provided, and that the organizations themselves do not intend to create and provide economic benefits to the resource providers in return for the resources received.

"Not intend to provide economic benefits" here does not deny that the organizations earn economic benefits. Not-for-profit organizations may also earn economic benefits and accumulate surplus as a result of activities in the process of pursuing organizational objectives related to public interest or common benefit. In such cases, the economic benefits earned will be used for future activities carried out under the objectives of the organizations.

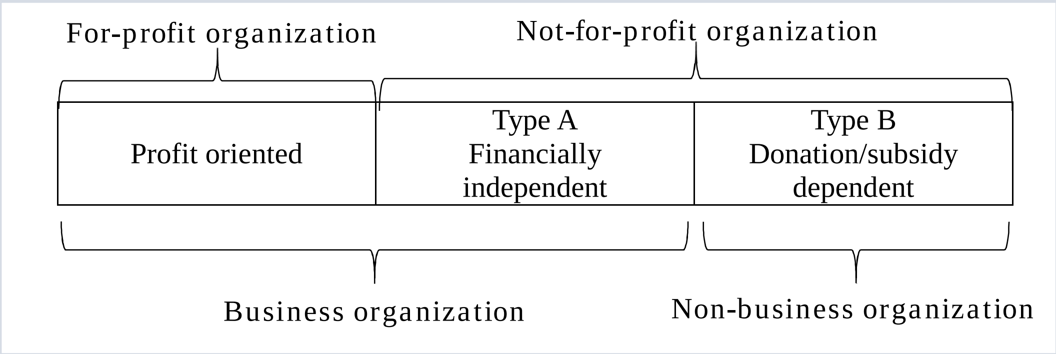
(3) Sources of fundraising

An organization whose financial resources are obtained from revenues from the sale of goods and services may be called a business organization, while an organization whose financial resources are obtained from the inflows of resources other than revenues from the sale of goods and services may be called a non-business organization. According to the Financial Accounting Standards Board (FASB) Research Report "Financial Accounting in Nonbusiness Organization: An Exploratory Study of Conceptual Issues" (hereinafter the "Anthony Report")[2] of the not-for-profit organizations that are not profit oriented, those falling under business organizations are categorized into Type-A not-for-profit organizations (hereinafter "financially independent organizations"), while those falling under non-business organizations are categorized into Type-B not-for-profit organizations (hereinafter "organizations dependent on donations and subsidies") [Figure 4].The FASB's Financial Accounting Concepts No. 4 *Objectives of Financial Reporting by Business Enterprises* (hereinafter

[2] Robert N. Anthony, FASB Research Report, "Financial Accounting in Nonbusiness Organizations: An Exploratory Study of Conceptual Issues"[1978]

FASB Concepts Statement No. 4) highlights the difference in the sources of fundraising and targets donations and subsidies-dependent organizations.

Figure 4: For-Profit and Not-for-Profit Segmentation in the Anthony Report



One of the reasons for establishing a financial reporting framework by dividing reporting entities according to differences in fundraising sources is that financially independent organizations and organizations dependent on donations and subsidies differ in the business model, which is a basis of accounting. In this regard, the Anthony Report specifically discusses the rationale for taking the approach whereby reporting entities are divided based particularly on the following points in connection with fundraising sources:

1) Differences in the measurement of services: Financially independent organizations measure services by revenue, while revenue does not constitute a measure of services for organizations dependent on donations and subsidies.
2) Distinction between capital transactions and business transactions: As to resources provided, financially independent organizations have no restrictions, while organizations dependent on donations and subsidies do have restrictions. Therefore, the latter needs to distinguish between unrestricted inflows that can be used at the discretion of the organization and restricted inflows..
3) Restraint on using-up of resources: For organizations dependent on donations and subsidies, it is important to provide information on the status on restraint and usage of resources.
4) Tax income: For many of the organizations that are dependent on donations and subsidies, tax income is part of their financial resources.
5) Irrelevance of purposes: Differences in accounting purposes between for-profit and not-for-profit organizations do not represent differences in accounting concepts.

Indeed, the approach whereby reporting entities are divided according to differences in fundraising sources have some issues. That is, in recent years, the distinction between for-profit and not-for-profit organizations has become increasingly ambiguous, making it difficult to clearly divide the two. In Japan, the number of corporations whose operations are dependent on both income from donations and subsidies and revenue from sales of goods and services has been on the rise. This trend will likely intensify given the rent policy trend. Also, given the preferential treatment of deemed donations in place, corporations are incentivized to fund their operations with the combination of income from donations and subsidies and revenue from sales of goods and services. Some organizations intended to serve the public interest, such as social welfare corporations, are dependent on public resources as their main sources of fundraising based on the social insurance system, while earning revenue directly from sales to customers. These organizations may receive requests to secure resources in the form of Endowment Funds, even if they are not imposed any restriction on the use of resources provided by resource providers. For not-for-profit organizations that have both business and non-business characteristics, the financial reporting framework for not-for-profit organizations must be designed so that the framework is applicable to economic activities seen in business organizations.

Meanwhile, some point out that the accounting for for-profit corporations designed for listed companies has expanded the scope of fair valuation within the framework of a mixed measurement model of accounting, which places emphasis on its usefulness in decision-making based on the predictions of future cash flow by investors, and thus, comprises both the fair valuation and the valuation at acquisition cost[3]. The information provided in accounting for for-profit corporations, therefore, cannot meet the information needs of the providers of resources to financially independent organizations. If, based on this recognition, the scope of the accounting standards for not-for-profit organizations is limited only to the type of organizations dependent on donations and subsidies, we need to separately establish the accounting standards for financially independent organizations, which will bifurcate the accounting standards for not-for-profit organizations. Such a consequence is not what this report aims for.
Based on the points above, under the Model Accounting Standards this time, we have decided to include both the financially independent organizations and the organizations dependent on donations and subsidies in the scope of not-for-profit organization, and to build a framework of financial reporting in a manner to properly reflect the differences of fundraising sources in accounting.

(4) Eligibility to distribute resources

Not-for-profit organizations may also produce economic benefits through their business activities, and thereby accumulate surplus. As to their eligibility to distribute resources, we considered whether the corporations allowed to distribute surplus should be included in not-for-profit organizations.

The eligibility to distribute resources of an organization is closely related to the question of whether resource providers have an ownership interest in the organization. *FASB Concepts Statement No. 4* of the United States points out that non-business organizations are characterized by the fact that they are provided with resources with repayment or economic benefits proportionate to resource provided; they have organizational purposes other than earning profits; and they have no clearly defined ownership interest that may be sold, transferred or redeemed, or provide the holders of such interest with the right to be distributed residual resources at the time of liquidation of the organization.

In Japan, besides companies, some corporations are allowed to pay resources that are part of their net assets to resource providers. For example, general incorporated associations, public interest incorporated associations and incorporated medical associations have established funds.[4] If the amount of net assets exceeds a prescribed amount, the funds may be returned to their contributors within the amount of such excess of net assets. In addition, in cases the ownership of residual assets are not prescribed in the articles of incorporation of a general incorporated association/foundation, the ownership may be prescribed by resolution of the general assembly or board of councilors of the corporation in liquidation, which we believe suggests that distribution of residual assets to employees, etc. is possible[5] Medical corporations subject to transitional measure[6] have the holders

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[3] Changes in the Role of Accounting Due to Emphasis on Fair Value (2012, Accounting Studies Group, Institute for Monetary and Economic Studies, Bank of Japan)

[4] Funds are monetary or other assets contributed to a corporation which the corporation has the obligation to return based on agreements with the contributors of such funds. If the amount of net assets exceeds a prescribed amount, the corporation is permitted to return such assets up to the amount of such excess of net assets by a resolution at the annual general assembly meeting. No interest may accrue on a claim pursuant to the return of funds. (Article 131, 141 and 143 of Act on General Incorporated Associations and General Incorporated Foundations (Act No. 48 of 2006, hereinafter "General Act" in footnotes), and Article 30-37 and 30-38 of Enforcement Regulation on the Medical Care Act (Order of the Ministry of Health and Welfare No. 50 of 1948).

[5] No provision in the articles of incorporation which grants the employees/founder the right to receive any surplus monies or residual assets are effective (Article 11-2 and Article 153-3-2 of the General Act). When the ownership of residual assets is not prescribed, the ownership is prescribed by resolution of the general assembly or board of councilors of the corporation in liquidation. Residual assets of which ownership is not prescribed by the resolution belongs to the national treasury (Article 239 of the General Act).

[6] No deadline is set for the transitional measures. According to *Changes in the Number of Medical Corporations by the Type per Year* (the official website of the Ministry of Health, Labour and Welfare), the medical corporations subject to transitional measures (39,716 corporations) account for 73.6% of all medical corporations (53,944 corporations) as of

of equity interest who reserve the right to claim the distribution of residual assets. Consumer cooperative associations have a pool of contributions from their members but have no concept of ownership interest. If members unsubscribe from the association, they are permitted to withdraw their contribution. The associations, however, are not allowed to distribute surplus monies, etc.[7] Nonetheless, the associations are allowed to rebate surplus monies to members based on the volume of their service received and the amount of their contribution, as well as residual assets in dissolution, although with some restrictions[8].

In reviewing the eligibility of not-for-profit organizations to distribute resources, if they are permitted to distribute their surplus monies which are the resources earned through organizational activities, we have decided to determine whether they are intended to provide economic benefits to resource providers, by taking into account the size of such economic benefits, the risks that the resource providers are supposed to bear, and whether the resource providers expect to receive economic benefits in return for the resources they provide.

(5) Objectives of financial reporting

In this review, we have positioned the followings as the objectives of financial reporting for not-for-profit organizations: providing stakeholders including resource providers and creditors with the information useful in decision-making, and fulfilling the accountability as to how the organizations have used the resources provided.

The information provided through financial reporting affects the decision-making by resource providers on the choice of the recipients of resources, etc. The information also helps resource providers to confirm how the resources provided were used in recipients' organizations, as well as to determine whether the uses were reasonable. For resource providers to appropriately serve supervisory functions, it is imperative that the recipients fulfill their accountability as to the use of the resources provided.

In addition, given that not-for-profit corporations established for the purpose of serving specific public interests are granted many benefits, such as preferential tax treatment and subsidies, we can argue that they are indirectly entrusted with resources from citizens and local communities in Japan. Indeed, citizens and local communities also may be positioned as resource providers in a broader context, we find it difficult for them to affect the organizations through their economic decision-making. However, even for resource providers in such a broader context, a report from a not-for-profit organization will serve as a means to broadly communicate that the resources entrusted are used efficiently and effectively in accordance with institutional purposes, thereby fulfilling accountability based on stewardship.

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the end of March 2018.

[7] Unsubscribed members may, in accordance with the provisions of the articles of incorporation, request a refund of all of part of their contributions (Consumer Cooperatives Act (Act No.200 of 1948, hereinafter the "Consumer Cooperatives Act"). However, the Consumer Cooperatives Act has no provision that corresponds to the provision regarding the transfer of interest at the time of voluntary withdrawal in the Agricultural Cooperatives Act (Act No. 132 of 1947, hereinafter the "Agricultural Cooperatives Act") (Article 21 of the Agricultural Cooperatives Act).

[8] *Research Report on Ideal Method of Accounting for Consumer Cooperatives* (2014, Japanese Consumers' Co-operative Union) points out that "the accounting for consumer cooperatives differ from accounting for for-profit corporations particularly in portions related to net assets" in that "contributions are deemed not be made for the purpose of earning profits exceeding the amount of interest" and that "structurally, the members do not have the right to claim surplus monies depending on the amounts of their contribution."

(6) Intended users

As to financial reporting of not-for-profit organizations, we reviewed whether we should assume only resource providers and creditors as primary users or whether we should include a wider range of stakeholders such as beneficiaries and employees as intended users.

Resource providers and creditors, such as donors, are considered to be especially interested in the financial information provided through financial reporting. However, if financial reports are prepared with a focus solely on the information required by resource providers and creditors, the information needs of other stakeholders may not be satisfied. For example, the Japanese government has pointed out in its recent studies that social welfare corporations should fulfill their accountability to local residents and users.[9] From that perspective, the government has pushed forward with designing systems related to information disclosure and organizational governance. Indeed, we have witnessed a growing demand from society for establishing a financial reporting framework that meets the needs of diverse stakeholders in a broad and balanced manner.

The problem here is that the volume of information to be provided could be enormous and financial statements could be too complicated if the financial reporting framework is constructed in a manner to meet diverse information needs of a wide variety of stakeholders. From the perspective of cost-effectiveness, we believe we should focus on important information needs. In reviewing whether to include the evaluation of stewardship in the objectives of financial reporting and what information to provide through financial reporting, we can meet the needs of local residents and beneficiaries by focusing on the information needs common to direct resource providers such as donors and grant providers, as well as governments, insurers, and resource providers in a broader context such as taxpayers and the insured.[10] In addition, we expect that the financial reporting framework developed this way will be quite useful in light of the needs of other stakeholders.

Based on the points above, in this review, we have positioned resource providers and creditors as the main information users of the financial reporting of not-for-profit organizations. Resource providers here include not only direct resource providers, but also indirect resource providers such as taxpayers and the insured.

(7) Information needs

We sorted out and identified the information needs of intended users with a view to providing the information that helps resource providers and creditors make decisions and also ensuring that not-for-profit organizations fulfill their accountability based on stewardship.

To provide the information useful for decision-making, we need to take into account the purpose of the use of financial reporting by resource providers and creditors. Resource providers provide resources necessary for activities by not-for-profit organizations to achieve their objectives. The information provided by a not-for-profit organization through its financial reporting affects the decision by the donor, etc. on whether or not to provide resources to the organization, and the choice of a recipient of resources based on its business, activities and scale, as well as the timing of providing resources.

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[9] Future of Social Welfare Corporations (Study Group on the Future of Social Welfare Corporations, the Ministry of Health, Labor and Welfare, July 4, 2014)

[10] For not-for-profit organizations that operate medial or nursing care business, medical service fees and nursing-care benefits are their primary financial sources. When they operate business under the healthcare or nursing-care insurance system, the operations of many of these organizations are funded by social insurance premiums paid by the insured (subscribers). Insurers pool social insurance premiums paid by the insured and pay the premiums to each operator through organizations that review and pay medical bill. The insured, thus, are not direct resource providers but are direct resource providers.

Resource providers expect not-for-profit organizations to deliver social services and achieve positive results towards solving problems by serving public interest or engaging in activities that contribute to public interest under their purposes. Creditors who hold credit claims against not-for-profit organizations also have similar information needs with a view to determining the recoverability of the funds they provided.

Creditors are interested in the credit profile of not-for-profit organizations, especially their capacity to continue activities. The information provided through financial reporting affects creditors' decision-making on whether to enter into a transactional relationship with the organization and their judgement as to recoverability of the funds they have provided.

On the other hand, from the viewpoint of accountability based on stewardship, it is important that the resources provided are used in line with the purposes of resource providers, besides the provision of information about the activities of the organization. Not-for-profit organizations, therefore, must fulfill information needs as to whether the resources provided are used appropriately, especially in a manner conforming to or consistent with specified uses.

Based on these points, we have concluded that financial reporting should cover the following three in order to satisfy information needs: 1) the capacity to continue activities, 2) organizational activities, and 3) the consistency with the purposes of resource providers.

(8) Qualitative characteristics of useful financial information

In order to achieve the objectives of financial reporting, which are the provision of information useful for decision-making and fulfilling accountability based stewardship, we reviewed the qualitative characteristics required of financial information. In the process of review, we referred to the international frameworks for accounting for for-profit corporations and public accounting.

First, we have concluded that financial information should satisfy the following two basic characteristics: relevance and faithful expression. Relevance is a characteristic that can make a difference in decision-making by the users of financial information and affect their understanding of the status of resource usage in an organization, while faithful expression is a characteristic that ensures the information faithfully depicts its intended phenomenon. Faithful expression is built on the following three characteristics: completeness, neutrality, and being free from material errors.

The usefulness of financial information is enhanced by the following four characteristics: comparability, verifiability, timeliness, and understandability, which are referred to as enhancing qualitative characteristics, compared to basic qualitative characteristics. Specifically, they are positioned as the characteristics that further enhance the usefulness of financial information to the extent that the information satisfies the basic qualitative characteristics.

Cost is one of the general prerequisites for the information provided through financial reporting. While preparing and reporting financial information deliver benefits to the users of financial information, the preparers have to incur the costs for gathering, processing, verifying, publishing and spreading the financial information. In applying the concept of cost as a requisite, we evaluate whether the benefits of reporting specific information outweigh the costs incurred in connection with providing and using such information.

(9) Elements of financial statements

Of the information needs that financial reporting of not-for-profit organizations is expected to satisfy, assets, liabilities, and net assets are the components of the information that represent an organization's capacity to continue its activities ("stock approach" based information), while revenues and expenses are the essential components of the information that represent the activities of an organization ("flow approach" based information).

We have identified the elements of financial statements in financial reporting of not-for-profit organizations as follows:

- Assets: Economic resources controlled by an entity as a result of past transactions or events which are expected to provide the entity with economic benefits or the ability to offer services in the future
- Liabilities: Obligations for an entity to surrender or transfer assets or provide services as a result of past transactions or events
- Net assets; The net amount of economic resources attributable to an entity[11], defined as a difference between assets and liabilities
- Revenues: An increase in net assets due to an inflow of economic resources or a decrease in liabilities
- Expenses: A decrease in net assets due to using-up of economic resources or fulfillment of obligations

The problem here is whether the assets of not-for-profit organizations – economic resources – are limited only to those that deliver economic benefits or also include those that do not deliver economic benefits. Not-for-profit organizations often hold assets as a foundation for their activities to achieve organizational objectives related to public interest or common benefit, even if such assets do not constitute the sources of future cash inflows. The status of such resources is important information for resource providers and creditors in understanding the organization's capacity to continue its activities. In addition, from the viewpoint of understanding organizational activities, it is imperative that depreciable/amortizable resources, which are the sources of the organization's ability to provide services in the future, are recognized in assets and depreciated/amortized each fiscal year based on the status of their utilization, or specifically, in a manner to reflect the degree of the organization's efforts through its activities. In view of the above, we have decided to include, in the assets that are an element of financial statements, the resources that constitute the sources of the organization's ability to provide services and achieve its organizational purposes, which contribute to public interest or common benefit.

(10) System of financial statements

To present the elements of financial statements, as accounting information, in a manner to clarify their organic relationship, the following two statements are required: a balance sheet which is a record of assets and liabilities at a point in time, and a statement of financial activities which shows increases/decreases in net assets derived from revenues, expenses, and their differences. To present the elements of financial statements, as accounting information, in a manner to clarify their organic relationship, the following two statements are required: a balance sheet which is a record of assets and liabilities at a point in time, and a statement of financial activities which shows increases/decreases in net assets derived from revenues, expenses, and their differences. Since not-for-profit organizations are not intended to engage in capital transactions that generally entail capital contributions, all activities that cause net assets to increase or decrease fundamentally are reflected in the balance sheet, which is a record at a point in time providing "stock approach" based information via the statement of financial activities, which is a statement of flows.

Information regarding the flow of funds is also essential to understanding the financial soundness of an organization. Documents showing the flow of funds include a statement of cash flows and a

[11] Including both positive and negative numbers

financial flow statement. We have concluded the statement of cash flows should be included in financial statements given that we should focus on the information on the flow of funds since the statement of financial activities provides information regarding the flows of economic resources, that we should unify the scope of the funds in view of the external reporting purposes of the financial statements, that we should place emphasis on the link between the balance sheet and the statement of financial activities, and that we should take into account the workload of the preparers of financial statements.

(11) Recognition in financial statements

In the Discussion Paper titled *Conceptual Framework of Financial Accountin*g published by Accounting Standards Board of Japan (ASBJ) in 2006 (hereinafter the "ASBJ Discussion Paper"), recognition in financial statements is defined as recording elements on the face of the financial statements.[12] The ABSJ Discussion Paper lists the following two as requirements for elements to be recognized in financial statements.

1) When an underlying contract is executed by at least one of the counterparties, and
2) A certain level of probability is estimated as to the likelihood of a future event related to an element of financial statements to occur.

In the framework of financial reporting for not-for-profit organizations, the question is whether "execution by at least one of the counterparties" should be a requirement for recognition. The ASBJ Discussion Paper discusses, "The first sentence of the preceding paragraph states that a bilateral agreement that is not executed by either party is not, in principle, recognized in financial statements," which we believe is a requirement focused on recognition in bilateral agreements. Meanwhile, in not-for-profit organizations, unilateral contracts including the reception of donations, are considered important economic activities like bilateral transactions. In view of such characteristics of the activities of not-for-profit organizations, we believe that recognizing items only when they have satisfied the definition of elements of financial statements in the wake of the occurrence of transactions or events will help cover a variety of economic activities. In addition, the probability of the occurrence of such transactions or events and the objective measurability of the items to be recognized (i.e. measuring the items to be recognized in monetary units in a credible manner) will ensure that the items qualify as elements of financial statements.

In light of these points, we have concluded that in not-for-profit organizations, items will be recognized as elements of financial statements only when they meet both the following requirements, on condition they concurrently meet the objectives of financial reporting:

1) Items have satisfied the definition of elements of financial statements in the wake of the occurrence of certain transactions or events
2) The occurrence of such transactions or events are probable to a certain extent, and the items can be measured in monetary units in a credible manner.

[12] Chapter 4-1 of *The Conceptual Framework in Financial Accounting* ASBJ Discussion Paper

(12) Measurement in financial statements

Measurement in a financial statement refers to assigning amounts in monetary units to items to be recorded in financial statements. The following is the fundamental components of the measurement in financial statements listed in "The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities" formulated by the International Public Accounting Standards Board (IPSASB) [Figure 5].

Figure 5: Measurement Bases for Elements of Financial Statements

Assets	Liabilities
・ Historical cost ・ Market value ・ Replacement cost ・ Net selling price ・ Value in use	・ Historical cost ・ Cost of fulfillment ・ Market value ・ Cost of release ・ Assumption price

The IPSASB's conceptual framework does not take an approach to specifically prescribe the fundamental treatment of the measurement bases; the framework only discusses the characteristics of each of the measurement bases.

Our review of financial reporting for not-for-profit organizations is built on an assumption that, fundamentally, a set of measurement bases should be selected as appropriate, based on the recognition that establishing a single set of measurement bases hampers the efforts to cover a variety of economic activities by not-for-profit organizations.

(13) Measurement of assets

While based on these basic assumptions, we needed to work out the basic idea on how to choose a set of measurement bases for not-for-profit organizations. We therefore deepened our discussions about the Fundamental Concepts with an emphasis on the measurement bases for assets in not-for-profit organizations.

The purpose of not-for-profit organizations is to contribute to public interest or common benefit for the organizations rather than providing economic benefits to resource providers. The information needs to be satisfied by financial reporting are following three: (1) the capacity to continue activities, (2) organizational activities, and (3) the consistency with the purpose of resources providers to provide resources. Of these, to satisfy the needs (2) and (3), it is desirable that an asset is succeeded for the value at the time of initial measurement, and that efforts are represented in financial statements through continued recognition of its depreciation/amortization. The value at the time of initial measurement here is generally the value of transaction at the time of acquisition. In unilateral transactions such as donations, however, an asset is measured at fair value. In light of such purpose and information needs of financial reporting in not-for-profit organizations, we believe that using historical costs as a measurement base is more appropriate in satisfying the information needs, compared to the measurement of assets in accounting for for-profit corporations.

5. Model Accounting Standards

The Model Accounting Standards set forth rules on how to prepare financial statements in not-for-profit organizations in accordance with the Fundamental Concepts of Financial Reporting; and are organized based on the existing systems of not-for-profit organizations, each accounting standard operated under them, and their treatment in accounting practices. While the "I. General review" discusses the assumptions for the standards, the "II. System of financial statements" systematically clarifies what the Model Accounting Standards will address by showing the composition of entire financial statements. Also, "III. Recognition and measurement and related disclosures" discusses the methods of recognition and measurement of individual items in the order of assets, liabilities, net assets, revenues, and expenses, in accordance with the elements of financial statements, and provide notes on items that require supplemental information. In addition, "IV. Notes and forms" lists model notes and forms of financial statements. The background of the review processes and conclusions for each item, as well as the guidelines for application of the Model Accounting Standards are outlined below.

I. General review

This section first discusses the "going-concern assumption." The reason is that the going-concern assumption is a fundamental underlying assumption of all accounting processes. It is made clear that the Model Accounting Standards also have been prepared based on this assumption.

The Model Accounting Standards apply to not-for-profit organizations only if these organizations continue their activities. The Standards, therefore, are not applicable in cases where the organization is slated to liquidate itself, cease its operations, has no practicable alternatives other than doing do, or intends not to continue its activities. For example, the Standards are not applicable to not-for-profit organizations in cases where:

- A decision to start rehabilitation proceedings was canceled, or a rehabilitation plan was disapproved
- A petition for bankruptcy proceedings was filed
- Decision was made that operations would be discontinued through consultation, etc. with related parties, not based on procedures stipulated by laws and regulations
- The organization was ordered to discontinue its operations by an administrative agency

Next, the Model Accounting Standards demand that not-for-profit organizations continue to apply the accounting policy adopted in preparing financial statements each fiscal year, and disclose changes in the accounting policy, if any. In addition, the principle of materiality is discussed in the General Review as it constitutes a requisite principle.

II. System of financial statements

Financial statements consist of three statements: a balance sheet representing the status of all assets, liabilities and net assets on a balance sheet date, a statement of financial activities representing all revenues, expenses and other increases/decreases in net assets during a single fiscal period, and a statement of cash flows representing the flow of funds. This policy is based on the conclusion of the Discussion Paper.

1) Classified presentation in balance sheet

On presentation of assets

The Discussion Paper (8-4) has concluded that if the uses of resources are restricted in not-for-profit organizations, and accordingly, the uses of specified assets are restricted, presenting such restricted assets separately from other assets in a balance sheet will contribute to understanding the capacity of activities and the liquidity of assets for an organization. For example, the Accounting Standard for Public Interest Corporations (The Public Interest Corporation Commission of the Cabinet Office) stipulates that the presentation of non-current assets shall be classified into fundamental property and specific assets. Accounting Standards for Social Welfare Corporations (Ministry of Health, Labour and Welfare) also has implemented a presentation classification of fundamental property.

In this review, in providing information on assets whose uses are restricted, we first considered whether to disclose the asset classification information on the face of a balance sheet or in its notes. In the process of such consideration, we referred to the U.S. FASB standards where information was increasingly disclosed in notes. When disclosing the status of restrictions on uses on the balance sheet, assets must be classified based on whether their uses are restricted or unrestricted, in addition to whether they are current or non-current, as well as what forms of assets they are. We were concerned that this could make the presentation more complex and difficult to understand. We therefore have decided to disclose the status of restrictions on uses in notes, rather than on the face of a balance sheet, placing priority on the disclosure of liquidity which is related to fundraising needs.

Next, we considered the following three approaches used to determine the scope of restricted assets presented in notes: (1) all assets, (2) tangible fixed assets (undepreciated balances) and financial assets only, and (3) financial assets only. In disclosing the status of restriction on uses, if an emphasis is placed on its linkage with the disclosure of net assets by the restriction on uses, all assets whose uses are restricted must be presented in notes. In this review, however, we have decided not to seek the linkage between assets and net assets in terms of their restricted/unrestricted uses, so we can focus on proving only the important information that satisfy the needs of the users of financial information.

However, to facilitate the understanding of organizations' capacity of activities, the information on the status of restriction on uses about important assets, such as land and buildings, is essential; and from the perspective of satisfying the information needs related to the liquidity of funds, the status of restrictions on uses needs to be disclosed for all financial assets. We therefore have decided to disclose, of all restricted assets, only the important assets, as well as all financial assets irrespective of the level of their importance in notes..

On presentation of net assets

Although, in the Discussion Paper, it is concluded that net asset should be classified into unrestricted assets, temporarily restricted assets, and permanently restricted assets, we decided to deepen discussions again as the U.S. FASB adopted two-tier classification – unrestricted and restricted – in its standards. As a result, we have concluded that presentation with the three-tier classification is imperative to properly communicate the financial position of an organization to the users of financial information, given that, while the assets that an organization is required to keep holding as its financial base and the assets whose uses are restricted due to agreements, etc. with resource providers differ significantly in characteristics, such differences cannot be presented clearly with the two-tier classification, making it difficult for the users of financial information to understand precisely the financial resources that constitute the foundation of an organization. Based on views that judgement as to the permanency of restrictions is difficult, we adopted a manner to divide net assets into Endowment Funds and Restricted Funds, from the point of view that we faithfully address the aim to clarify the resources that constitute the foundation of an organization and thus eliminate the ambiguity of the judgement [Figure 6].

Figure 6: Classification of Net Assets

Endowment Funds	The portion of net assets that an organization is required to keep holding as the foundation of its organizational activities and is accounted for separately from other net assets in accordance with prescribed events. To use these net assets, an organization has to go through a prescribed set of procedures, including the approval of relevant authorities, decision by governing bodies such as the board of directors, and agreement with resource providers.
Restricted Funds	Net assets whose uses are restricted in accordance with agreement with resource providers or decisions by governing bodies (these assets fall under the Endowment Funds, however, when they have to be accounted for separately as Endowment Funds, etc. with a view to sustaining the foundation for the organization, even if their uses are restricted)
Unrestricted Funds	Net assets whose uses can be decided at the discretion of the organization

Endowment Funds are recognized upon occurrence of the events prescribed by laws and regulations, etc., such as the acquisition of resources for specified purposes, and through decisions by a decision-making body such as the board of directors of the organization. The amount of Endowment Funds changes only through the procedures of addition/subtraction, coupled with a decision by a governing body, as prescribed by laws and regulations or in the articles of incorporation, etc. of the organization. The remeasurement of assets acquired using the resources classified under the Endowment Funds do not affect the amount of Endowment Funds.

By contrast, Restricted Funds are recognized when the uses of net assets are restricted due to agreement with a resource provider or a decision by a governing body of the organization. Therefore, changes in the valuation of the assets acquired using the resources, other than valuation differences on available-for-sale securities, will affect the amount of resources whose uses are restricted (i.e. Restricted Funds).

In determining whether or not the uses of net assets are restricted, we will take into consideration not only the restrictions of uses based on agreements with resource providers but also the cases where their uses are restricted by the reporting organization itself through the decision by its governing body, like Specified Cost Reserve Funds for a public interest corporation.

As the classification of net assets is an important information, we will disclose the information on balance sheets. Discussion Paper (8-3) argues that the presentation of net assets by the classification may be omitted or may not be omitted in cases where the balance of any one of the asset classifications is zero. We therefore have decided to omit the presentation by the classification when the balance of either the Endowment Funds or the Restricted Funds is zero, taking into consideration the negative factors, such as the cumbersome procedures required and the reduced clarity, and placing an emphasis on more simple and clear presentation.

2) Classification for presentation in the statement of financial activities

Presentation by activity

The statement of financial activities should be presented in three categories: ordinary activities, which shows revenue and expenses arising from ordinary activities; other activities, which shows revenue and expenses arising from other activities; and transfers between net asset categories, which shows changes in net assets that occur due to factors other than these activities. Major overseas accounting standards, such as the U.S. FASB standards, have no provisions for the use of such step-by-step presentations by activity category but do not restrict it if the entity that actually engages in activities considers such classification to be necessary. This classification offers a number of advantages in terms of readability of statements of activities and has therefore been adopted.

Presentation by restriction category

Following the conclusion of Research Report No. 25, the statement of financial activities with parallel entries has been adopted in the Discussion Paper. The reasons for the adoption are as follows: with this method, resource inflows presented by restriction category makes it possible to grasp their restriction status; the release of restrictions and transfers between categories are distinguished from resource inflows in the current period; and creating a separate account for a change in the restriction category will make it clear that the transaction is an internal transfer (helping avoiding the misunderstanding that revenue is double-counted).

In the case of adopting the parallel entry method where resource inflows are presented by restriction category, the proposal in the Research Report No. 25 sets forth two forms: one is to transfer the amount used to Unrestricted Funds, and the other is to deduct the expenses from the Restricted Funds, each of which has the following characteristics.

[Method of transferring the amount used to Unrestricted Funds]

When Restricted Funds are used in accordance with their restrictions, the amount equivalent to the used amount is transferred from Restricted Funds to Unrestricted Funds. According to this method, expenses match revenues in the year when the expenses are incurred in the unrestricted category. In addition, the increase in Unrestricted Funds provides an indication of the amount of revenue that has come under the full control of the organization.

[Method of deducting expenses from Restricted Funds]

When Restricted Funds are used in accordance with their restrictions, expenses are recorded in the Restricted Funds category. According to this method, expenses match revenues in each of the restricted and unrestricted categories. Although the revenue at the time of resource inflows will match the expenses, the amount of revenue that has come under the full control of the organization due to the release of restrictions will not be reflected in the statement of financial activities for the current period. Therefore, such information will be disclosed in the notes (breakdown, increase/decrease and balance of net assets restricted for use).

After reviewing these two methods, we have decided to adopt the latter because it is considered to better meet the needs of information users, especially funders (such as donors and creditors), since the latter indicates how the restriction on the resource has been released in the category of resource inflow, based on the assumption that the resource inflow is initially recognized as revenue.

It has been decided that changes in Endowment Funds will not be presented in the statement of financial activities in light of the objective of the statement, which is to respond to information needs on the status of activities of not-for-profit organizations by showing their resource flows. Among the factors that increase or decrease net assets, information on the flows of Endowment Funds, which is not included in the statements of activities, is supplemented by notes (addition to, subtraction from, and balance of Endowment Funds). In addition, net assets restricted for use shall be omitted when there is no such item, from the viewpoint of improving the clarity of presentation and eliminating the complexity of practice.

Presentation method for expense accounts

There are two possible methods of presenting expenses in the statement of financial activities: one is classification by nature and the other is by activity. We considered which method provides more useful information, taking into account the treatment under the current system and the characteristics of not-for-profit organizations.

The U.S. FASB standard provides examples of the presentation of program A, program B, management and general expenses, and fund raising expenses, and adopts the activity-based classification (functional classification) for expenses. In addition, taking into account the treatment under the current system in Japan, it is considered desirable to use the activity-based classification. We concluded that this presentation method is consistent with external reporting purposes because it clarifies how the resources donated to the organization are used in each program. Meanwhile, it has been decided to disclose expense information classified by nature in the notes, as it shows a breakdown of expenses incurred by an organization and contributes to the understanding of the status of organizational management.

1) Presentation method for statement of cash flows

While adopting the statement of cash flows as a financial statement to show the flow of funds, we also discussed how to incorporate some of the approaches of the financial flow statement into it.

This is because it is widely observed that the financial flow statement is still used in the current system and practices to show the flow of funds in not-for-profit organizations. Taking these circumstances into consideration, the gradual introduction of the statement of cash flows is realistic and is considered desirable as a way to develop the system. In principle, the statement of cash flows is prepared by presenting gross income and gross expenditure per major transaction (direct method). However, in the category of cash flows from operating activities, the presentation using the indirect method (simplified method) is allowed, where adjustments can be made only with short-term receivables and payables such as accounts receivable, accounts payable, advance payments and advances received. Specifically, lines for adjustment accounts are added below net cash used in the cash flows from operating activities section of the statement of cash flows. The details of the adjustments are stated in the notes.

The indirect method is used by many companies in preparing a statement of cash flows. The method starts with profit and adjusts it by adding or subtracting non-cash profit and loss items, changes in non-cash assets and liabilities, etc. to or from it. However, since not-for-profit organizations are those organizations that do not operate with the aim of making profits, the indirect method, which uses profit as a starting point for preparation, is not considered to be appropriate for such organizations to use. Therefore, we have decided not to permit the indirect method.

III. Recognition and measurement and related disclosures

1) Financial assets

Financial assets have been classified into monetary claims, securities and derivatives. In the Discussion Paper, we reviewed securities among these, focusing on issues specific to not-for-profit organizations.

Classification of securities by purpose of holding

We have reviewed the classification of securities by purpose of holding. Although securities held for trading or strategic purposes were not assumed at the time of summarizing issues in the Discussion Paper, now we see some situations where these cases are possible, therefore, we have concluded that the classification of securities held for not-for-profit organizations does not differ from that under ASBJ Statement No. 10, "Accounting Standard for Financial Instruments" (hereinafter referred to as the "Accounting Standard for Financial Instruments").

Definition of shares in a subsidiary company and shares in an affiliated company

With respect to shares in a subsidiary company and shares in an affiliated company, we have decided to adopt not only a formal criteria based on the percentage of shares held, but also substantial criteria including cases where an organization has substantial control or influence over them. In this regard, there is no reason to give special consideration to not-for-profit organizations in adopting the approaches of Accounting Standard for Financial Instruments. The scope of related parties is also determined based on substantive factors, as stated in the note on the details of transactions with related parties. We have attempted to achieve consistency between the definition of shares in a subsidiary company and shares in an affiliated company and the scope of related parties by introducing substantive criteria. However, as group information and other information will be discussed going forward, this is only a clarification of our current approach.

Valuation method for shares in a subsidiary company and shares in an affiliated company

In the Discussion Paper, shares in a subsidiary company and shares in an affiliated company held were determined to be valued at cost because they are held for the purpose of direct contribution of funds. This time, following the valuation method for shares in an a affiliated company (shares in a specified affiliated company and shares in an affiliated company) specified under Incorporated Administrative Agency Accounting Standards (Incorporated Administrative Agency Accounting Standards Study Group) (hereafter referred to as "IAA Accounting Standards"), it was discussed whether to use the lower-of-cost-or-market method, to apply the equity method and reflect changes in market value in the statements, or to include the market values in the note to meet information needs. As a result, in light of the fact that group information remains an issue to be further discussed at this stage, it has been decided not to adopt the method of including the market value information of these shares in the financial information, but to continue to value them at cost, while further discussing this issue going forward.

Presentation of valuation differences of securities

We discussed how to treat valuation differences arising from the mark-to-market valuation of securities. As a result, it was decided that valuation difference on trading securities should be presented in the ordinary activities section of the statement of financial activities.

As for valuation difference on available-for-sale securities, presenting it in the net assets section of the balance sheet was considered, since including it in the statement of financial activities defeats the objectives of preparing the statements. Specifically, it was considered whether the amount equivalent to the valuation difference should be included in or separately presented from net assets classified by restriction category. The valuation difference on available-for-sale securities that are not assumed to be traded in the short term is different in nature from that on trading securities. Therefore, in order to help information users understand the organization's capacity to continue its activities, it has been determined that the valuation difference on available-for-sale securities shall be separately presented below net assets by restricted category, instead of being included in it.

Impairment loss on securities

Because impairment losses on securities other than trading securities do not arise from ordinary operating activities, they are presented as expenses in other activities section in consideration of the nature of the activity. The same shall apply to cases in which impairment losses have occurred on securities held as Endowment Funds.

Monetary claims and derivatives

Regarding monetary claims and derivatives, there are no circumstances specific to not-for-profit organizations that need to be considered in introducing the approaches of Accounting Standard for Financial Instruments. As a result of review with reference to the current system of not-for-profit organizations and IAA Accounting Standards, we have specified only accounting standards that are deemed necessary in practice for not-for-profit organizations.

2) Inventories

As for inventories, there are no circumstances specific to not-for-profit organizations that need to be considered. As a result of review with reference to the current system of not-for-profit organizations and IAA Accounting Standards, we have decided to adopt the lower-of-cost-or-market method as the accounting standard for valuation of inventories.

3) Property, plant and equipment and intangible assets

With regard to property, plant and equipment and intangible assets, accounting for impairment of fixed assets was named as a factor specific to not-for-profit organizations that need to be considered. In December 2017, the Not-for-Profit Organization Accounting and Audit Practice Committee of the Japanese Institute of Certified Public Accountants (JICPA) published Research Report No. 34, "Discussion Paper for the Development of Accounting Standards for Not-for-profit Sectors - Impairment of Fixed Assets" (hereinafter referred to as "Research Report No. 34"). For other items, as a result of review with reference to the current system of not-for-profit organizations and IAA Accounting Standards, we have decided to allow multiple treatments for depreciation, respecting the individual treatment of each not-for-profit organization system, due to their varieties in systems.

4) Lease transactions

With respect to lease accounting, we specifically discussed the accounting treatment for finance leases that do not transfer the ownership of leased assets to the lessee and whether or not to allow a simplified method for calculating interests, with reference to the current system of not-for-profit organizations and IAA Accounting Standards. As a result, it was found that similar accounting methods to that used in ASBJ Statement No. 13, "Accounting Standard for Lease Transactions" (hereinafter referred to as "Lease Accounting Standard") have been adopted in most cases.

The U.S. FASB Standard and the U.K. Charities Statement of Recommended Practice (hereinafter referred to as "U.K. SORP") adopt an accounting method similar to the Lease Accounting Standard in Japan. Both standards are in the process of revising the accounting

treatment of operating leases to treat them as sale/purchase transactions in principle, but this has not been introduced in Japan yet.
Based on the results of the above review, it has been determined that finance leases shall be accounted for as normal sale/purchase transactions in principle, where lessees engaged in finance lease transactions not involving the transfer of ownership shall treat them as normal sale/purchase transactions in principle, and necessary notes shall be made on leased assets. If leased assets are immaterial, they are accounted for in a manner similar to that applicable to rental transactions. In addition, operating lease transactions shall be accounted for in a manner similar to that applicable to ordinary rental transactions, and necessary notes shall be made regarding future lease payments for non-cancelable leases.

5) Impairment of fixed assets

Regarding the impairment of fixed assets, Research Report No. 34 has been published based on the Discussion Paper as already stated. The model accounting standards incorporated the approach stated in Research Report No. 34 as described in III.5 Impairment of Fixed Assets in Supplementary Material 2. The first thing to be determined in the impairment flow is the classification of assets. Considering the characteristics of the assets held by, and the operations of, not-for-profit organizations, we discussed the optimal measurement basis according to the nature of the assets held, and have determined to apply impairment accounting separately to cash-generating assets and non-cash-generating assets.

In addition, because it may be a considerable burden in practice to review whether to recognize impairment losses for all assets or asset groups, it has been decided to conduct such review only when there is an indication of impairment.

We believe that the impairment method we present incorporates the characteristics of the assets held by not-for-profit organizations to the fullest extent, but it should be noted that the classification of these assets reflects the management’s policy on corporate management. For assets classified as cash-generating assets, it is expected that the investment will be recovered through funds obtained through the use of the asset, whereas for assets classified as non-cash-generating assets, such scenario is not assumed and new resources must be provided by funders in order to recover the investment. Please refer to Figure 7 for the flow of applying impairment accounting.

Purpose of introducing impairment of fixed assets

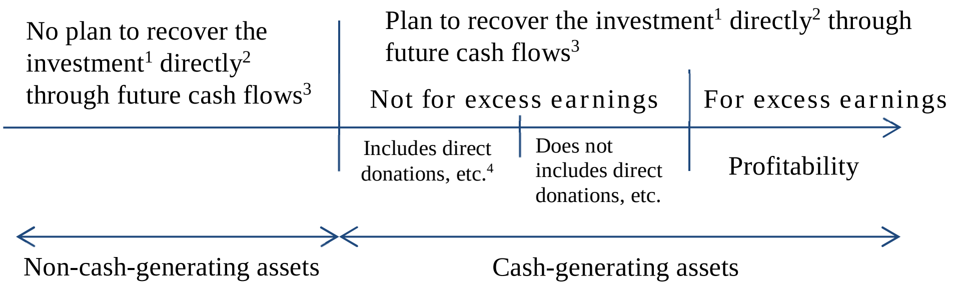
It is appropriate to measure the assets of not-for-profit organizations using historical cost given consistency with information needs. However, if the value of an asset has declined significantly and is considered unlikely to recover, it is necessary to remeasure the asset by applying impairment accounting to reduce the carrying amount to an amount that is appropriate for the value of the asset, taking into account the organization’s capacity to continue its activities, the state of its activities, and consistency with the objectives for which the resources are provided.

The appropriate presentation of the future cost of activities by reducing the carrying amount of assets that is excessive relative to the recoverable invested capital or the capacity to provide services will help information users understand the status of the reporting organization’s activities.

Characteristics and asset classification of not-for-profit organizations

Not-for-profit organizations have cash-generating assets for which the investment is assumed to be recovered through future operating revenues, etc., and non-cash-generating assets for which the investment is not assumed to be recovered. These assets are characterized by the fact that they are used in connection with each business or program operated by corporations, which is based on the resource flow unique to not-for-profit organizations. The main sources of revenue for not-for-profit organizations are membership fees, donations, subsidies, and program/business revenue. These revenues either are, or are not directly tied to individual businesses. For cash-generating assets, a self-supporting accounting system is applied to the business to which the assets are attributable, and in some cases, excess revenue can be expected. On the other hand, with respect to non-cash-generating assets, no self-supporting accounting is applied to the business to which the assets are attributable, and losses arising from the business are covered by revenue sources within the organization. The decision on whether an asset held is cash-generating or non-cash-generating is made according to the process shown in Figure 7. Details of major cash-generating and non-cash-generating assets will be stated in the note.

Figure 7: How to determine whether an asset is cash-generating or non-cash-generating



Notes:
1. The amount of investment depends on the cost (the fairly valued amount in case of receipt of gifts)
2. Cash flows that are not directly tied to the use of assets or asset groups are not included (e.g., membership fee revenues and costs in divisions).
3. Donations, subsidies and other sources of revenue received for the purpose of improving facilities are not included (e.g., facility improvement subsidies).
4. Donations, etc. are limited to ordinary or continuing donations, etc. and extraordinary donations, etc. that the organization surely expects to have.

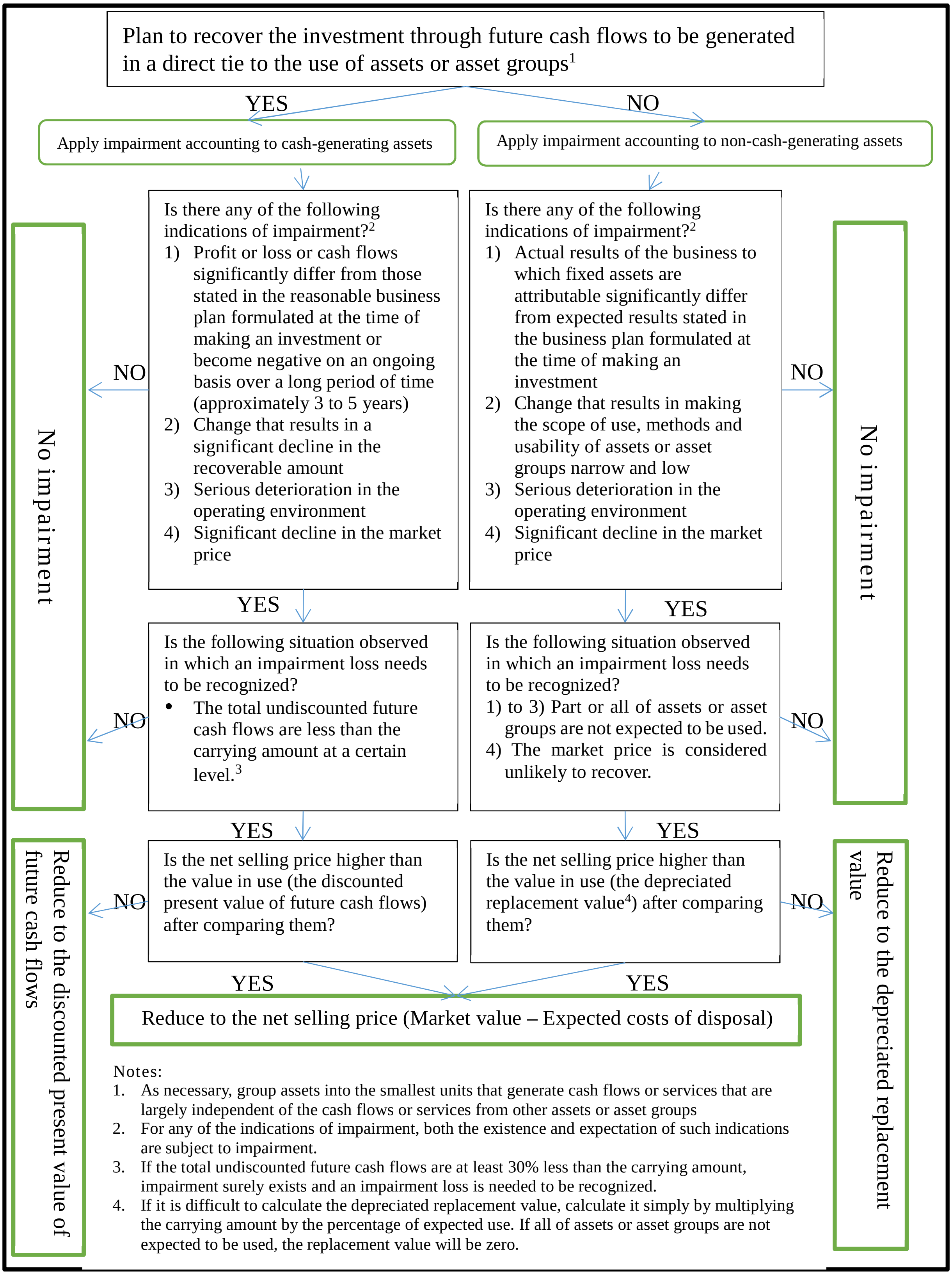
Recognition and measurement of impairment losses

Assets or asset groups are classified in accordance with Figure 7 above and impairment accounting is applied in three steps.

a. Determine whether there is any indication of impairment
b. If there is an indication of impairment, the entity shall determine whether to recognize impairment based on whether the existence of impairment is deemed to be fairly certain.
c. The amount of impairment loss is measured for assets or asset groups for which it has been determined that an impairment loss should be recognized.

Recognition of impairment in b. for non-cash-generating assets includes the steps of determining whether the situation described in (1) to (3) in Figure 8 is applicable. The determination that no impairment is required is based on the premise that the entity considers the possibility of continuing to provide the relevant service. The consideration should include financial aspects, and the results are reflected in the business plan, which is assumed to be decided by the decision-making body of the organization, such as the board of directors.

Figure 8: Application flow for impairment accounting in not-for-profit organizations



Notes:
1. As necessary, group assets into the smallest units that generate cash flows or services that are largely independent of the cash flows or services from other assets or asset groups
2. For any of the indications of impairment, both the existence and expectation of such indications are subject to impairment.
3. If the total undiscounted future cash flows are at least 30% less than the carrying amount, impairment surely exists and an impairment loss is needed to be recognized.
4. If it is difficult to calculate the depreciated replacement value, calculate it simply by multiplying the carrying amount by the percentage of expected use. If all of assets or asset groups are not expected to be used, the replacement value will be zero.

6) Transactions in foreign currencies

With respect to transactions in foreign currencies, there are no circumstances specific to not-for-profit organizations that need to be considered. As a result of review with reference to the current system of not-for-profit organizations and IAA Accounting Standards, we have determined to introduce the necessary provisions related to transactions that are normally considered to occur in not-for-profit organizations.

7) Financial liabilities

Regarding financial liabilities, there are no circumstances specific to not-for-profit organizations that need to be considered. As a result of review with reference to the current system of not-for-profit organizations and IAA Accounting Standards, the issuance of bonds as a means of raising funds emerged as a main issue. Reviewing the laws and regulations regarding the issuance of corporate bonds in each not-for-profit organization system revealed that public interest corporations, general corporations, and social welfare corporations do not have a system for issuing bonds, but Incorporated Educational Institutions and social medical corporations are institutionally permitted to issue corporate bonds. Therefore, in order to respond to these bond issuance systems, we have decided to include the accounting treatment of not-for-profit organizations that can be issuers. For other monetary obligations, as there are no circumstances specific to not-for-profit organizations that need to be considered, we have decided to introduce provisions for the accounting treatments as deemed necessary in practice.

8) Retirement benefit obligations and provision for retirement benefits

With respect to retirement benefit accounting, as there are no circumstances specific to not-for-profit organizations that need to be considered, we reviewed details with reference to the current system of not-for-profit organizations and IAA Accounting Standards. Under the current system in Japan, most of the accounting standards adopted the simplified method based on the principle approach in retirement benefit accounting. Although there is a difference in the scope of application of the simplified method, the method under the accounting standard allows an entity to record provision for retirement benefits in the full amount payable at each fiscal year end in accordance with its retirement benefit regulations.

We have decided to respect the accounting standards adopted under the current system, since they are in line with the U.S. FASB standards and the U.K. SORP. As a result, it has been decided that the principle method (projected benefit obligation accounting) should be used to record provision for retirement benefits and that the simplified method should be allowed in certain cases to calculate retirement benefit obligations. Under the principle method, in the case of defined benefit plans, pension assets are deducted from retirement benefit obligations and the net amount is recognized as liability. In the case of defined contribution plans, the amount of contribution required is charged to expenses. When the number of employees is less than 300, or when the number of employees is 300 or more but the calculation by the principle method may not result in figures that consistently have a high degree of reliability due to unevenness in age or period of service, the use of the simplified method is allowed to calculate retirement benefit obligations in lump-sum retirement allowance plans.

9) Asset retirement obligations

As for asset retirement obligations, there are no circumstances specific to not-for-profit organizations that need to be considered. As a result of review with reference to the current system of not-for-profit organizations and IAA Accounting Standards, we have determined to introduce the necessary provisions related to transactions that are normally considered to occur in not-for-profit organizations.

10) Tax effect accounting

Regarding tax effect accounting, as a result of review with reference to the current system of not-for-profit organizations and IAA Accounting Standards, it has been determined that a factor specific to not-for-profit organizations is the effect of corporate tax applied only to the revenue-generating business segment, which uses effective tax rates taking into account deemed donations; and considers the recoverability of deferred tax assets. The following formula shows how to calculate an effective statutory tax rate as a reference.
An effective statutory tax rate is calculated from tax rates for corporate tax, inhabitant tax, and enterprise tax based on taxable income. Since enterprise tax is deductible in the calculation of taxable income when paid, the fundamental formula of effective statutory tax rate is generally expressed as follows:

$$\text{Effective statutory tax rate} = \frac{\text{Corporate tax rate x (1 + Local corporate tax rate + Inhabitant tax) + Enterprise tax}}{\text{1＋Enterprise tax}}$$

If there is a provision for “deemed donations” specified under the Corporation Tax Act, which is one of the preferential tax treatment for public interest corporations, etc., the effective statutory tax rate shall be calculated by taking into account the effect of deemed donations. The specific formula for calculating the effective statutory tax rate in the case where deemed donations are considered is as follows:

$$\text{Effective statutory tax rate} = \frac{\text{Corporate tax rate x (1-a*) x (1 + Local corporate tax rate + Inhabitant tax) + Enterprise tax x (1-a*)}}{\text{1＋Enterprise tax x (1-a*)}}$$

*The variable “a” represents the percentage of deemed donations.

11) Revenue

In September 2016, Not-for-Profit Organization Accounting and Audit Practice Committee published Research Report No. 30, “Discussion Paper for the Development of Accounting Standards for Not-for-profit Sectors - Recognition of Earnings without Repayment or Economic Benefits Proportionate to Resource Provided” (hereinafter referred to as “Research Report No. 30”). The focus of the discussion in the Report is on earnings without repayment or economic benefits proportionate to resource provided (revenue from non-exchange transactions) among revenues in not-for-profit organizations. In the model accounting standards, accounting standards related to revenue recognition in general were reorganized; and specific standards for recognition of revenue from exchange transactions were also reviewed with reference to ASBJ Statement No. 29, “Accounting Standard for Revenue Recognition” (hereinafter referred to as “Revenue Recognition Accounting Standard”).

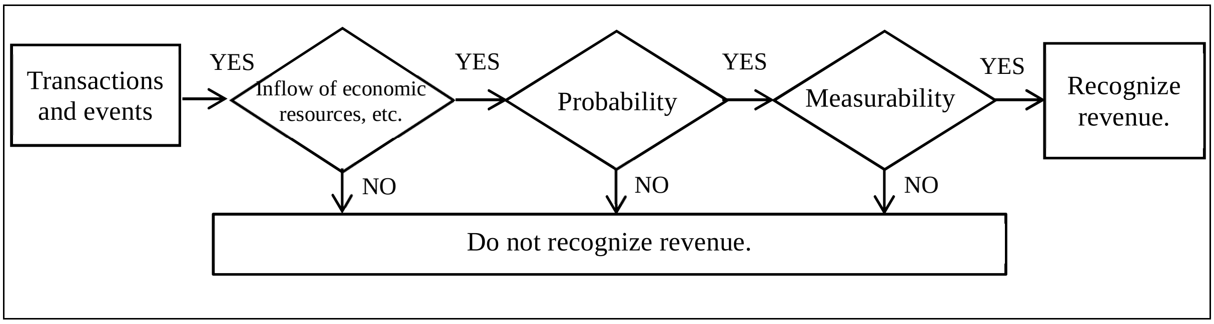
Revenue recognition requirements in Research Report No. 30

Revenue in not-for-profit organizations shall be recognized if all three of the following requirements are met. The flow of recognition is illustrated in Figure 9.

Revenue recognition requirements

1. Net assets increase due to an inflow or increase in the value of economic resources or a decrease in liabilities (hereinafter referred to as “inflow of economic resources, etc.”). 2. The transaction is unlikely to be revoked and highly likely to be performed (hereinafter referred to as “probability”). 3. The resource can be measured reliably in monetary terms (“measurability”).

Figure 9: Revenue recognition flowchart



Until now, revenue in not-for-profit organizations has been divided into two categories: “earnings with repayment or economic benefits proportionate to resource provided” and “earnings without repayment or economic benefits proportionate to resource provided.” However, there are some types of earnings with small repayment or economic benefits proportionate to resource provided, such as sales at low prices and donations with returns, thus, the above two classifications are not sufficient enough to properly reflect the actual practice. Therefore, the model accounting standards focused on whether a transaction is based on an “exchange of value” or not, and has revised the method to classify transactions as either “exchange transactions” or “non-exchange transactions”.

In this review, we deepened the discussion on revenue recognition requirements and decided to establish general concepts for revenue recognition that encompass both exchange and non-exchange transactions.

Inflow of economic resources, etc.

With regard to the inflow of economic resources, Research Report No. 30 defined it as “an increase in net assets resulting from an inflow or increase in the value of economic resources or a decrease in liabilities (hereinafter referred to as “inflow of economic resources, etc.”). However, since its definition overlaps with that of revenue and the reduction of liabilities also needs to be considered, it has been decided to change its definition to “the acquisition of rights to economic resources or the release of obligations to transfer economic resources by a not-for-profit organization as a result of a transaction or other event.”

Research Report No. 30 states that donations, etc. with restricted use in non-exchange transactions shall be recognized as revenue “when the not-for-profit organization has access to the relevant resources and is in a position to determine its future use within the scope of the agreed use.” The term “substantially” in Paragraph 190 of the model accounting standards, which amplifies this subject, refers to the case where the future of economic resources can be determined by the organization itself.

Certainty

Research Report No. 30 states on revenue recognition that “the transition is highly likely be performed,” but since revenue from exchange transactions is recognized on the assumption that the transaction is performed, we have decided to focus only on the probability of revocation. In addition, as the term “probability” means the “degree of certainty,” and from the perspective of indicating the extremely high possibility of a transaction being performed, it will make more sense if we use the term “certainty,” instead of “probability,” and therefore, it has been decided to change the expression to “the possibility that a transaction or other event may be revoked is extremely low (hereinafter referred to as “certainty”).”

Recognition criteria for revenue from exchange transactions

In addition to the above, it has been decided that the fundamental concept of the Accounting Standard for Revenue Recognition (*1) shall apply mutatis mutandis to the recognition criteria for revenue from exchange transactions, and that its consistency with accounting for for-profit corporations shall be ensured by adopting the same revenue recognition timing: the time of fulfillment of contractual performance obligations (*2).

(*1) Content of the fundamental concept
In an exchange transaction, in principle, an entity shall recognize revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. (Paragraph 16 of the Accounting Standard for Revenue Recognition)

(*2) Timing of recognition: Upon fulfillment of contractual performance obligations
The right to economic resources is transferred to a not-for-profit organization by the performance of its contractual obligations. Revenue is recognized when or as performance obligations are satisfied by the transfer of goods or services promised by a not-for-profit organization to a customer. (Paragraph 35 of the Accounting Standard for Revenue Recognition)

In the Accounting Standard for Revenue Recognition, the process of revenue recognition is expressed using a five-step approach. However, the approach is not used in this report because it is not an appropriate way to describe revenue recognition for not-for-profit organizations. The approach for the identification of contracts and performance obligations is described in Paragraphs 174 and 175.

Revenue from exchange transactions is generally recognized in the Unrestricted Funds category, but since revenues generated from sales at charity events (revenue-generating business) and other businesses are those subject to restrictions on use, we have added a provision in Paragraph 186 regarding restrictions on use.

Recognition criteria for revenue from non-exchange transactions

Research Report No. 30 states that revenue should not be automatically recognized when the right to receive cash, etc. arises due to the conclusion of a gift contract or determination of a subsidy grant, etc. nor should revenue be recognized based solely on the established fact of receipt of resources, but rather, judgments regarding revenue recognition should be made by focusing on the certainty of performance of the relevant contract. The model accounting standards adopt a similar approach, where it is necessary to clarify on what basis a transfer date of rights should be determined with the agreement of both parties. This requirement is the same as that of exchange transactions, but the comparison of both should highlight the characteristics of revenue recognition in non-exchange transactions.

Personal services provided free of charge or at low prices and loan for use

Information such as the provision of personal services free of charge or at low prices, which is typical of the activities of not-for-profit organizations, needs to be reflected in the statement of financial activities. However, because of the challenges in measuring their values, it has been decided not to recognize revenue arising from these activities in the statement of financial activities, but to disclose as much information as possible in the notes.

The details shall be provided as a footnote to the statement of financial activities to make their monetary values comparable with the revenue and expenses in the statement of financial activities by presenting them in a tabular form after calculation under a certain process, and as a supplementary material with information on the content, scale and calculation method of such services.

12) Expenses

For expenses, we have established a clause for cost accounting. As there are no circumstances specific to not-for-profit organizations that need to be considered, we reviewed details with reference to the current system of not-for-profit organizations and IAA Accounting Standards. Since cost accounting is applied to a limited number of industries and types of business, the treatment in cost accounting has been prescribed in documents other than the respective accounting standards of not-for-profit organizations. As there is no particular matter to be considered for not-for-profit organizations, it has been decided that the generally accepted cost accounting standards shall be followed.

IV. Notes and forms

1) Forms

We have presented a model of the notes and forms of financial statements. For the format of the financial statements, it has been decided to present financial figures for two years, but during the review, there was a difference of opinion as to whether the order of the years should be the previous year and the current year or vice versa. The model accounting standards have determined, in order to avoid complicating information in presenting the statement of financial activities, that the figures for the previous year are to be presented as totals without any restriction categories, and therefore, the sequence of the current year and the previous year has been adopted. For consistency, the same order shall be applied to other financial statements.

2) Notes

Notes specific to not-for-profit organizations were reviewed in accordance with III Specific Matters on Recognition and Measurement and Related Disclosures (Paragraphs 114, 145, 153, 164, 165, and 166) in Supplementary Material 2, and others were reviewed with reference to the current system of not-for-profit organizations and IAA Accounting Standards. As a result, it has been decided to classify the notes as follows to contribute to the convenience of users of financial information by making it as concise as possible and also to reduce the burden on the preparers of the information. Of the notes presented in the model accounting standards, the items required as notes to the financial statements for each legal entity form are expected to reflect their respective characteristics. However, it has been determined that, in preparing notes to the financial statements, only the required items should be noted according to the following policy.

<Notes to financial statements>

a. Matters necessary for understanding financial information of a not-for-profit organization
b. Matters to be stated where any matter to be stated in the notes has occurred
c. Matters to be stated where they are material

It has been decided to specify the following items as notes specific to not-for-profit organizations.

- Breakdown, increase/decrease, and balance of assets with restricted use
- Notes on impairment of fixed assets
- Addition to, subtraction from, and balance of Endowment Funds

- Breakdown, increase/decrease, and balance of net assets with restricted use
- Breakdown of operating and administrative expenses by nature
- Provision of services free of charge or at low prices
- Breakdown of adjustment accounts when the statement of cash flows is prepared using the simplified method

As for the items to be included in notes, we have presented general items as a model in Paragraph 223. Among the notes, we will supplement the notes on the premise of a going concern.

The model accounting standards assume that a not-for-profit organization is in an environment where it can continue its activities; and are not applicable if this is not the case with the reporting organization. Therefore, the management of a reporting organization is required to review the assumption that the organization will continue its business activities. If any event or circumstance occurs that raise significant doubts about the assumption, the management needs to state to that effect and the details thereof in the “Notes on Going Concern Assumption.”

With regard to notes on the details of transactions with related parties, the issue is to what extent the scope of related parties should be covered in the notes. It is considered that transactions with corporations and individuals who may have substantial control or significant influence over the reporting organization may be subject to disclosure by notes. We believe that this issue will be discussed in detail in the upcoming discussion on group information.

Closing

In this report, we proposed the fundamental concepts of financial reporting and the model accounting standards for not-for-profit organizations as a framework independent from that for accounting for for-profit corporations.

In developing the fundamental concepts of financial reporting, we organized the approaches for achieving the objectives of financial reporting by taking into account the organizational characteristics of not-for-profit organizations, the objectives of financial reporting, and the needs of users. We expect that the fundamental concepts of financial reporting will underlie the development of accounting standards, and also serve as a reference in determining specific accounting treatments in practice in the future. The model accounting standards reflect the fundamental approach presented under the fundamental concepts of financial reporting while giving consideration to consistency with treatments in individual accounting standards, etc., prescribed for not-for-profit organizations as a legal entity form. A major challenge in developing a framework that is commonly applicable to the not-for-profit sector is how to balance the fundamental concepts of financial reporting with their practical application.

Since the publication of Research Report No. 25 in 2013, JICPA has been working to build a common financial reporting framework that reflects the characteristics of not-for-profit organizations. In the course of our deliberations, we deepened our discussions from a variety of perspectives, with opinions received from experts who participated in the Not-for-Profit Organization Accounting Committee, preparers of financial reports in not-for-profit organizations, stakeholders who are users of such reports, and those involved in the entities that formulate accounting standards applicable to each legal entity form. This report was finally made public after a long-term review, thanks to the enormous cooperation of all concerned parties. We would like to take this opportunity to express our sincere gratitude.

Going forward, when accounting standard setters of each legal entity form revise the institutional accounting standards, we hope that referencing the model standards in the process of amending them will yield greater consistency of financial reporting across legal entity forms, thereby leading to wider use of such information by donors, creditors and a wider range of stakeholders to not-for-profit organizations. JICPA will continue to contribute to the development of financial reporting for not-for-profit organizations by advancing the review of model accounting standards and individual issues, while deepening cooperation and collaboration with many related parties.

– END OF REPORT –