Financial Reporting of International Organizations

Voluntary contributions are the main issue

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1. Current Reform of Financial Reporting

International organizations, or more precisely intergovernmental organizations, such as the United Nations (UN), the World Health Organization (WHO), the World Food Programme (WFP), the European Commission (EC) or the Organization for Economic Co-Operation and Development (OECD), just to mention a few of them[1], have recently undertaken major reforms of their financial reporting or are still in the process of these reforms. The reforms, which are in most cases in the context of wider management reforms, are aiming for an improvement towards «transparent financial reporting, strong accountability and good governance» (UN 2006a, 5). Others, such as the European Commission are more explicitly targeting the elimination of technical weaknesses of preliminary accounting systems, such as the reporting of assets and liabilities (EC 2002, 4).

Surprisingly, despite a wide range of organizations being involved on a global scale, including a large number of organizations based in Switzerland, there is absolutely no coverage of this development by scholars and little coverage by the accounting profession (FEE 2007; NAO 2007a; NAO 2007b). This almost complete absence of coverage is even more amazing, bearing in mind that the reforms are actually triggered by some discontent with the current financial reporting. Also this discussion, while it is apparently taking place amongst diplomats representing the member countries, is equally missed by the academia as well as the accounting profession. This article will investigate which are the main effects and considers the technically most controversial impact in more detail.

For the following analysis it is important to understand, where financial accounting and reporting of intergovernmental organizations stands before the reforms. Intergovernmental organizations were obviously influenced in their development by the member states. Therefore accounting and reporting is in many respects similar to public sector accounting and reporting. Both are strongly influenced by budgets, which are published and approved in a political process. Financial accounting and reporting is in both cases focussed on the reporting of budget execution (Bergmann 2009a, 10, 52; Schauer, 2009, 11). Traditionally, the basis of budgeting as well as accounting in cash, i.e. cash in- and outflows are budgeted and accounted for. The cash basis is in fact the starting point for most international organizations outside the UN system, e.g. that's where the EC started from (EC 2002, 5). The UN system, including all organizations under its umbrella, has been on what is called a modified cash basis for many years. This includes organizations like the WHO which are not controlled by the UN because they have their own member body, i.e. General Assembly. This modified cash sys-

[1] Another one discussed in this article is the PanAmerican Health Organization (PAHO)

tem is commonly referred to as United Nations System of Accounting Standards (UNSAS). Arguably, the UNSAS are modified cash or modified accrual, but the UN itself classifies them as modified cash, because of UNSAS falls short of the accrual principle even in some of the current positions (UN 2009, 20). However, the UNSAS financial statements include all typical elements of accrual accounting, including a balance sheet.

Both the Non-UN and the UN system organizations are, and this is another commonality with the public sector, extensively using fund accounting. Funds are used to distinguish and trace different sources of funding. Funds are a proxy for more detailed cost accounting systems, which are not common in smaller international organizations, while larger ones typically have project accounting systems. The projects are then bundled to larger and more comprehensive funds. A small number of funds are subsequently consolidated into the financial statements of the whole organization, although the fund level is presented in the financial report.

The following analysis is focussed on the UN system organizations. They are a large group of organizations with an identical status quo ante. The Non-UN organizations, on the other hand side, are much less homogenous and therefore less feasible for a systematic analysis.

1.1. Accounting and Reporting under UNSAS

The United Nations System Accounting Standards (UNSAS) were first issued by the United Nations General Assembly in 1991 and thereafter updated in eight revisions, the last one in 2007. Their primary objective is stated as «to provide a framework for accounting and financial reporting in the United Nations system which reflects generally accepted accounting principles, while taking account of the specific characteristics and needs of the system. A further objective is to promote consistent accounting and financial reporting practice between the organizations» (UN 2007, 2). The UNSAS, as stated are, rather a framework than a fully fledged accounting and reporting standard. In their latest revision, they count a little more than 20 pages including examples. They include a few principles, such as going concern, consistency and materiality. Interestingly these principles include the accrual principle, although the UN itself steps back from this claim in the training material supporting the transition to International Public Sector Accounting Standards (IPSAS).

UNSAS requires the presentation of four mandatory statements (the roman numbers are a required element of identification):

Statement I – statement of income and expenditure and changes in reserves and fund balances;
Statement II – statement of assets, liabilities, and reserves and fund balances;
Statement III – statement of cash flow;
Statement IV – statement of appropriations (which may be called schedule).

The names of the statement clearly address the fund accounting, which was introduced as a common feature of financial accounting and reporting by international organizations. Statement IV is basically a budget to actual comparison, which supports the strong emphasis of budgeting, as discussed in the previous chapter.

In further chapters, the UNSAS deliberate on currency issues, income and expenditures as well as assets, liabilities and reserves and fund balances. However, each position is only described in one or two paragraphs, which include the definition and mandatory disclosures. The UNSAS also refer to some of the International Accounting Standards (IAS), however to outdated versions and not to their full current suite of standards.

Although financial statements under UNSAS very much look like accrual financial statements, the accounting is based either on cash flows or sometimes on internal approval, e.g. for the procurement of assets the issuing of a purchase order is triggering recognition. Typically, most assets except cash, land and buildings are expensed and non-current liabilities are not recognized. Therefore, the balance sheet, although presented, is not reflecting the actual financial position of the organization. The income statement is equally not reflecting all revenues and expenses, as they are based on cash flows rather than the in- or outflow of assets or liabilities in general. On the other hand side, the financial statements are similar to the budget and only little to no reconciliation is needed in statement IV.

1.2. Adoption of IPSAS

In July 2006 the United Nations General Assembly decided to adopt the International Public Sector Accounting Standards (IPSAS) as their future accounting and reporting framework (UN 2006b, 3). This was after some Non-UN organizations, such as the EC, OECD, NATO or Interpol, but well before most national governments, except Switzerland and a few smaller countries which had taken the same decision slightly earlier (Bergmann 2006, 47).

IPSAS are full accrual accounting and reporting standards, based on the current International Financial Reporting Standards (IFRS), wherever there is no public sector reason to depart from these private sector standards (Caperchione 2006). Unlike UNSAS, IPSAS requires fair presentation, which should allow the user of the statements to have a true and fair view. All assets, liabilities, revenues and expenses have to be presented according to the accrual principle, i.e. the appropriate period based on the recognition of all assets and liabilities. Unlike IFRS, the IPSAS require the presentation of an actual against budget comparison. However, the budget is not the main determinant for the presentation of the entire financial statements (Bergmann 2009b).

The required statements under IPSAS include the following ones. Four of them are very similar to the UNSAS statements:
Statement of Financial Performance (similar to Statement I under UNSAS)
Statement of Financial Position (similar to Statement II under UNSAS)
Statement of Changes in Net Assets/Equity (not required under UNSAS)
Statement of Cash Flows (similar to Statement III under UNSAS)
Budget comparison (similar to Statement IV under UNSAS)
Accounting Policies and Notes (not explicitly required under UNSAS)

The budget comparison does not have to be a separate statement, but most likely it is in a separate statement as the presentation in an additional column is rarely sufficient.

The main addition in comparison to UNSAS is the Statement of Changes in Net Assets/Equity, which is, however, remotely related to the reconciliation of the funds under UNSAS. But unlike the reconciliation of the funds, the Statement of Changes in Net Assets/Equity is more focussed on the transactions affecting this position, rather than the consolidation of various positions/funds.

But the main difference between IPSAS and UNSAS is not in the presentation of the statements, but in the recognition and measurement of assets and liabilities. This will result in different financial information presented, even if the statements will not look very different at a first glimpse. This may or may not affect the bottom line, both in a favourable or unfavourable direction. But the bottom line under IPSAS is supposed to represent the financial situation in a true and fair way, something that was not explicitly intended by UNSAS.

2. Main issues of IPSAS adoption

After the 2006 decision by the UN General Assembly, different organizations within the UN system took different approaches and time frames to adopt and implement IPSAS. The first organization to present IPSAS compliant financial statements was the WFP which prepared the 2008 financial statements under IPSAS and presented them in spring 2009. They got an unqualified audit opinion, i.e. the confirmation from the auditors to be fully compliant with IPSAS.

Apart from project management and IT related issues, which are prevalent in any larger scale project, there are a few accounting and reporting issues which appear typical for international organizations and therefore shall be analysed in more details. These three issues are revenue recognition, expense recognition and liabilities for post-employment benefits, such as pensions and health insurance plans for retired employees.

Revenue recognition is a well known issue in accounting and reporting. In the private sector, the International Accounting Standards Board (IASB) and its American equivalent are undertaking a joint project which started in 2008 and is supposed to end with a new standard in 2011 (IASB 2009). IPSAS addresses revenue recognition mainly in two standards, one for revenue from exchange transactions (IPSAS 9) and another one for revenue from non-exchange transactions (IPSAS 23). This classification and the consequential accounting and reporting are new to international organizations. As they influence the entire revenue side of the statement of financial performance, they are highly relevant. In respect of non-exchange transactions, there is also little experience to build on, as this standard only became effective in June 2008 and is not based on a corresponding IFRS. This issue is examined more closely in chapter 3.

The second issue, expense recognition, is not a very common issue outside international organizations. It mainly arises from the current practise under UNSAS to recognize expenses based on purchase orders. Now purchase orders are just an internal document of authorization and are therefore not a common basis for recognition. Under IPSAS, as well as IFRS, recognition usually takes place upon delivery, when the exchange of good and services takes place and, importantly, the payment is due. This is usually after the purchase order is issued. However, this is not an issue which only arises in international organizations. Private corporations, as well as national and sub-national government bodies also have internal authorization mechanisms, which are not relevant for the recognition and recognize expenses upon delivery.

Post-employment benefits, the third issue, is also an issue for many organizations other than international ones. Often, the liability of the employer exceeds the assets set aside. Such liabilities, especially under defined benefit plans, are often large and can dramatically influence the balance sheet. Prominent examples include the airline industry or car manufacturers. While the pension plan of the UN system appears to be reasonably funded, there are different other schemes, namely health insurance, which are threatening the balance sheet of UN system organizations. But again, large liabilities for post-employment benefits are not specific to international organizations and this issue is therefore not examined more closely.

3. Revenue recognition under IPSAS

In the current suite of IPSAS there are two main standards for revenue recognition, IPSAS 9 Revenues from Exchange Transactions and IPSAS 23 Revenues from Non-Exchange Transactions (Taxes and Transfers). Obviously, there are other standards which address revenues in specific circumstances, such as IPSAS 11 Construction Contracts or IPSAS 13 Leases, however, these types of contracts are neither the main source of revenue for international organizations, nor are they causing any problem specifically for this kind of entity.

Under IPSAS 9 Revenues from Exchange Transactions, situations such as the sale of goods and services against an approximately equal consideration are addressed. Such transactions exist in international organizations. Most of them sell publications, gift cards or other merchandising items and charge the customer. Typically, this is not their main source of revenues, but nevertheless the proceeds are at a material level. Some organizations, such as WHO and PAHO, even have a bigger line of exchange transactions, as they procure drugs and vaccines and sell them, after charging a service fee, to their member states. Now the recognition of such revenues from exchange transactions of goods is based on the transfer of risks and rewards of ownership (IPSAS 9.28). In plain English this means that the international organization has to recognize the revenue when the good is delivered and the customer takes over the risk. For services, which are less common to international organizations, the stage of completion determines the recognition of the revenue, e.g. when 60 percent of a service is rendered, 60 percent of the contractual revenue shall be recognized (IPSAS 9.19). Bottom line, the recognition of revenue follows mercantile traditions.

Under IPSAS 23 Revenues from Non-Exchange Transactions (Taxes and Transfers), there is no equal consideration. The most obvious example of such revenues of international organizations is their assessed contributions, i.e. membership fees of the member states. These assessed contributions are typically based on socioeconomic indicators, such as the Gross Domestic Product (GDP), in order to reflect the variable strength of each member state. However, many of the activities of international organizations are not directed to individual member states. Even in those cases when a beneficiary can be identified, this is not based on the level of the assessed contributions; sometimes quite the opposite, as many organizations are specifically targeting developing countries. Thus there is no exchange of goods or services against a payment. In fact, assessed contributions are captured by the term transfer in IPSAS 23. The recognition of such revenues takes place when the transferred resources satisfy the criteria for recognition of an asset (IPSAS 23.76). Now often this asset is a receivable, rather than cash or something else. For assessed contributions, such a receivable is usually created when the contribution is assessed by the legislative body and the period begins, i.e. on 1 January of the membership year.

Nowadays, for many international organizations, assessed contributions are still important but are no longer the main source of revenue. Instead, voluntary contributions have become a very important source of revenue. Some organizations, for instance the WFP, rely entirely on voluntary contributions (WFP 2009a, 47). For others, such as WHO and PAHO, assessed contributions account for only about 20 percent of the total revenues (WHO 2009, 7; PAHO 2009, 8). For many UN system organizations such voluntary contributions are well above one billion USD per year, adding up to a multi billion transaction for all international organizations[2]. Voluntary contributions are donations from national governments, member states or occasionally non-members, as well as private sector donors, such as the Bill & Melinda Gates Foundation. Unlike the sources of revenue discussed above, such donations are not as simple to classify and to determine the appropriate accounting treatment. Are they exchange or non-exchange? Are there conditions attached to the transferred asset? On the other side, it is obvious that given the size or share of such donations, their accounting and reporting is highly material. The donors also represent an important group of stakeholders and users of financial reports.

[2] Unfortunately, there is no consolidated statistical information available.

3.1. Voluntary contributions

Based on the experience in WFP, WHO and PAHO, voluntary contributions are generally based on contractual agreements between the international organization and the donor. There is no legislation on such agreements and therefore they may include different provisions. The content apparently varies between the different UN system organizations. There is even some degree of variation between different donors within one organization. In an attempt to characterize to most relevant provisions, the following elements should be considered:

a) Duration: Some donations are to be used in a short period of time (e.g. donations to WFP in an effort to fight a hunger crises). Other donations are for multi-year projects, typically up to 5 and in a few cases even more years (e.g. many of the projects in the health sector undertaken by WHO and PAHO).
b) Obligation to use donation on purpose and return unused funds: Typically donations are to be used only for the specified purpose. The international organization may charge a small and clearly defined service or management fee, but the main portion of the donation has to be used for the purpose. If there's some money left, it has to be returned. The return obligation for unused funds, however, is more or less rigorously enforced in the different international organizations.
c) The purpose is an activity in a certain area and typically not the provision of a defined amount of services. The beneficiary of the activity is typically not identical with the donor. In some cases, a report on the activity is required for the payment of the last installment; however, this report is not the core activity itself.
d) Payment and implementation schedules vary substantially and are not strictly aligned.

Based on these four characteristics, voluntary contributions are non-exchange transactions. The lack of a direct exchange between the donor and the international organization, but also notion of activities rather than services successfully delivered, are indicators that there is no exchange relationship. Therefore recognition of the revenue is triggered by the recognition of an asset, i.e. when the organization has to recognize the asset, also the corresponding revenue has to recognized.

Again, in many cases such an asset may be a receivable. Obviously, a contractual payment schedule has immediate implications for the recognition of a receivable. If the amount is not due and payable, it should not be recognized as a receivable (IPSAS 23.31).

But even if the payment is due and payable, or even when it is received, the return obligation may or may not meet the definition of condition (IPSAS 23.17). If it meets the definition of a condition, a liability (or in other words a deferral) has to be recognized if it is probable that an outflow of assets is required to settle the obligation created by the condition (IPSAS 23.50). Due the characteristics a) and b) above, this situation may or may not exist.

For instance, if the donation is used within the reporting period, there may be no condition by year end. Then, the entire revenue should be recognized upfront within the year. Also in a multi-year contract with annual installments and therefore the receivable approximately equals the resources used, there is no liability at year end.

But on the other hand side, if in a multi year project, the installments do not correspond with the activities, it is likely that there is a condition according to IPSAS 23.17 and therefore a liability has to be recognized. It is a condition, if the recipient cannot avoid the outflow of resources, because it either has to spend them on future activities according to the contract or return them to the donor. But the contract wording and the history have to show there is no probable and realistic alternative other than the outflow. If, for instance, the organization has good record of persuading donors to waive the return obligation, there is no condition and no liability.

3.2. Financial Reporting of Revenues from Voluntary Contributions

The analysis in chapter 3.1 shows that the accounting and reporting for voluntary contributions may vary between different international organizations. While voluntary contributions generally appear to be non-exchange transactions, conditions may or may not exist.

Regardless the prevalence of conditions, a receivable is recognized when the contribution is due and payable. If there is no condition attached, the revenue is recognized in the same moment. However, if there is condition, only the inflow of assets exceeding the liability should be recognized as revenue upfront (IPSAS 23.44). Only when the condition is (partially) met and the liability (accordingly) reduced the respective revenue can be recognized (IPSAS 23.45).

To put it in less technical terms: If an organization receives voluntary contributions with no conditions attached, it has to recognize the full amount upfront. If there are conditions attached, the recognition only happens when the conditions are satisfied. If different organizations within the UN system have different contractual arrangements, which appears to be the case, there will be substantially different patterns of revenue recognition.

This may look like an unwanted outcome of the adoption of IPSAS. However, true and fair accounting standards are bound to present the economic substance of a transaction. If the substance of two transactions is indeed different, there is no way to present them uniformly. Therefore, any harmonization – if this is intended – has to address the substance of the transaction and not the accounting thereafter.

4. Conclusion

International organizations are currently undertaking a major development of their accounting and reporting framework, in order to enhance transparency and accountability. The impact on the financial situation presented will be substantial. Both revenue and expense accounting will be affected. The balance sheet will include more assets but also liabilities which previously were not presented, such as liabilities due to voluntary contributions.

Many of the changes are not specific to international organizations and can equally be observed in national and sub-national governments, some even in private corporations. However, the substance of revenue transactions is truly different in nature. International organizations typically experience both exchange and non-exchange transactions. The most idiosyncratic transactions are assessed contributions and voluntary contributions. Both are non-exchange transactions which should be recognized once the corresponding asset is controlled. Voluntary contributions are sometimes conditional, sometimes not. This variation in substance leads to a different accounting and reporting treatment of the transaction.

Zusammenfassung

In den internationalen Organisationen findet derzeit eine wichtige Entwicklung der Rechnungslegung und Finanzberichterstattung statt, mit dem Ziel die Transparenz zu verbessern. Die Auswirkungen auf die dargestellte finanzielle Situation der Organisationen werden beträchtlich sein. Kontrovers und in diesem Artikel erörtert ist die Erfassung und Darstellung der verschiedenen Erträge, insbesondere der freiwilligen Beiträge. Deren unterschiedliche Substanz in verschiedenen Organisationen lässt keine einheitliche Behandlung zu.

Résumé

Les organisations internationales mènent actuellement une évolution majeure de leur comptabilité, afin de renforcer la transparence et la responsabilisation. L'impact sur la situation financière présentée sera substantielle. La comptabilisation des contributions volontaires est discuté vivement. A cause des variations en substance, il aboutit à une comptabilisation différente dans les diverses organisations internationales.

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