International Financial Reporting for Non Profit Organizations

Technical Advisory Group

AGENDA ITEM: TAGCP06-02
March 5, 2020 – Virtual Meeting

Cash Transfers

Summary	The accounting treatment for cash transfers has been identified as a specific issue for the not-for-profit sector. This paper brings together material gathered from national and international standard setters.
Purpose/Objective of the paper	To allow TAG members to consider the nature of the issue, potential ways forward and text for inclusion in the Consultation Paper.
Other supporting items	None
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Actions for this meeting	Advise on: • The description of the issue and its relationship with other topics • Links to other international standard developments, national standards or other guidance • The need for any further input

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Cash Transfers

Part 1 – Advice Sought

1. **Consultation Paper Draft**

1.1 At the TAG meeting on November 4, the TAG agreed that the recognition and measurement of cash transfers should be included in the short list of issues to be included in the Consultation Paper.

1.2 Part 2 of this paper has been drafted for discussion, with the aim that the text is capable of being inserted directly into the Consultation Paper, subject to comments.

Question 1: What comments does the TAG have on Sections 1 and 2?

Question 2: Do the summaries of national-level and international guidance in Sections 3 and 4, together with Annex A, accurately reflect the current standards/ guidance? Is the TAG aware of any other guidance on cash transfers issued by national standard setters or other regulatory bodies that should be included in the Consultation Paper?

Question 3: Does the TAG agree with the presentation of the key issues in section 5, which link to other topics for inclusion in the Consultation Paper?

Question 4: What comments does the TAG have on the proposed SMCs in relation to this topic and are there other specific SMCs that could be raised?

2. **Next steps**

2.1 The text drafted below will be included in the Consultation Paper subject to any further comments from the TAG. The PAG will be consulted on any specific issues raised by the TAG further to this discussion.

Question 5: Is there specific input to be sought from the PAG?

February 2020

Part 2 - Draft Consultation Paper Text

Cash Transfers

1. Description of the issue

1.1 NPOs receive cash transfers from a variety of sources. These can take the form of grants, bequests, endowments and donations for ongoing operating activities, for specific projects, or for capital purposes. Cash transfers are received without the contributor receiving something of equal value for their direct benefit (non-exchange transactions).

1.2 Where NPOs receive cash transfers, the arrangement with the donor may stipulate the terms with which the NPOs must comply to be entitled to the cash. Stipulations include carrying out certain activities, spending the funds within a set time, and acquiring or constructing a capital asset (such as a building).

1.3 Stipulations may take the form of a condition, where the NPO is not entitled to the cash until it has complied with the condition. Where the NPO has received a cash transfer before it is entitled to the funds, the NPO will need to recognise that it has this obligation. Stipulations may also take the form of a restriction, where the NPO is entitled to the cash, but is restricted in how it can use those funds. There are different views about when a stipulation is a condition and when it is a restriction. This can create complexity for NPOs; they need to know how and when these cash transfers should be recognised as revenue in their accounts.

1.4 NPOs may receive cash transfers that include stipulations requiring funds to be returned to the donor if a specified future event occurs. For example, where the cash transfer is given for the construction of a capital asset; the stipulation may require the funds (or a proportion of the funds) to be returned if the NPO ceases to use the asset as intended. The requirement to use the asset as intended may be for a set period, or open-ended. The question is whether this stipulation is a condition that results in the deferral of the NPO's revenue until the risk of repayment has reduced; or whether the stipulation is a restriction, and the change in use that would trigger a repayment is a separate event.

1.5 Identifying cash transfers may not always be straightforward. For example, where the NPO provides a donor with some merchandise in return for a donation, it raises questions as to whether all of the donation should be treated as a cash transfer, or whether part of the donation should be treated as a purchase of the merchandise (an exchange transaction), with the rest of the donation being treated as the cash transfer. These different approaches could affect both the recognition and presentation of the revenue.

1.6 Revenue may be received in different reporting periods to the expenditure it is used to fund. This can make it difficult for readers of NPOs' financial statements to see how their funds were used and to identify the funds available for their ongoing activities. This can be a particular problem where the cash transfer has restrictions, and so the NPO can only use the cash for a particular activity.

1.7 Transparency about the amount of revenue that an NPO is entitled to recognise from cash transfers it has received in the current and subsequent periods is important. Also consistency of approach across NPOs is important for stakeholders to enable them to understand and compare NPOs.

2. Financial reporting challenges

2.1 Incoming resources are recognised when it is probable that the economic benefits associated with the transaction flow to the entity and the amount of revenue can be reliably measured. The NPO needs to have control over these resources. This applies to cash transfers as well as to other sources of revenue. The conditions included in some cash transfers may either prevent the NPO gaining control of the cash or give rise to a corresponding liability.

2.2 It is important that there is clear guidance, so that NPOs can clearly identify the stipulations in an agreement and determine whether these are conditions or restrictions. This affects when the NPO should recognise revenue. Conditions mean that the NPO will not be entitled to a cash transfer until it has performed certain activities. Restrictions may be recognised immediately but will limit how cash transfers can be applied (i.e. they can only be applied to specific purposes).

2.3 As a result, where cash transfers that include conditions are received prior to the NPO meeting all the conditions, the NPO may need to defer the recognition of revenue and instead recognise a liability. The liability represents its present obligation to undertake the activities necessary to meet the condition.

2.4 NPOs may therefore face a challenge in determining in which financial reporting period revenue is earned. Identifying the conditions and determining how they affect the recognition of the NPO's revenue can be a challenge as conditions may be general or not in practice enforced. The substance of the conditions imposed need to be considered not just their legal form. Guidance may be required on materiality and costs against benefits considered.

2.5 Cash transfers that include a condition to acquire or construct a long-term asset such as a building pose particular financial reporting challenges. The question arises as to when that condition is met – over the period that the asset is constructed or acquired, or over the lifetime of the asset.

2.6 With cash transfers, there is usually little difficulty in measuring the amount of the transfer, as it is given in cash. However, there are circumstances where the NPO may experience challenges in determining the amount of revenue to recognise in a reporting period. For example, where the receipt of the cash takes more than one year and it may be necessary to discount the revenue to its present value or where, as a result of the conditions attached to a cash transfer it is necessary to estimate the amount of revenue earned in each period.

2.7 Cash transfers need to be distinguished from other sources of revenue to ensure that NPOs can account for them appropriately. In many cases, this will be straightforward. However, there may be cases where a transaction includes elements of a cash transfer and elements of another type of revenue. In some cases, the cost of reliably identifying elements that are not cash transfers may exceed the benefit of the additional transparency, particularly where the value of those elements is not material.

2.8 To ensure transparency about the funds that an NPO can freely apply to meet its expenses, it is important that all revenue sources are clearly defined and accounted for consistently. Recognition and measurement of incoming resources from external sources – Chapter x discusses the overarching principles in respect of the recognition and measurement of revenue. This chapter should be read in the context of that discussion.

2.9 Presentation and disclosure requirements may be needed to complement the recognition and measurement requirements to ensure that readers have an accurate picture of the NPO's financial position. If revenue from cash transfers is deferred and recognised over more than one reporting period, this raises questions as to how the amounts should be presented. This issue is discussed in Financial statement presentation – Chapter x.

3. <u>Current international guidance</u>

3.1 Currently international guidance on cash transfers is included in the following standards[1]:

- IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*
- Section 24 *IFRS for SMEs*[2]
- IPSAS 23 *Revenue from Non-exchange Transactions* (Taxes and Transfers)

3.2 The guidance provided by the international standards is based on the core principle that revenue is recognised when it is probable that the entity will receive the economic benefits associated with the transaction and that it can be reliably estimated. Applying this principle would result in NPOs recognising revenue immediately when they received cash transfers that did not have any conditions.

[1] Other standards also address accounting for revenue in specific circumstances. This includes the standards for leases (lease revenues), revenue from construction contracts (IPSAS only), insurance contracts, and provisions, contingent liabilities and contingent assets. These are not included in the discussion of this topic.

[2] The International Accounting Standards Board has initiated a programme to review IFRS for SMEs and in particular to consider updates for IFRS standards issued since the last update. This includes IFRS 15 *Revenue from Contracts with Customers.*

3.3 With the exception of government grants, neither IFRS nor IFRS for SMEs[3] specifically address non-exchange transactions such as cash transfers. However, they do provide general recognition criteria for assets, liabilities, revenue and expenses, and the measurement bases to be adopted when recognition takes place.

3.4 IAS 20 provides guidance on the accounting of revenue from government grants. Revenue is recognised on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. IAS 20 allows grant revenue provided for capital assets to be recognised over the life of the asset, either by recognising deferred revenue in the statement of financial position, or by deducting the grant when determining the carrying amount of the asset[4].

3.5 IFRS for SMEs also addresses the treatment of government grants. Unlike IAS 20, IFRS for SMEs requires that a grant that imposes specified future performance conditions on the recipient is recognised as revenue only when the conditions are met. There is no option to deduct the grant when determining the carrying amount of the asset, and revenue is based on meeting the conditions, not over the life of the asset.

3.6 IPSAS 23 describes non-exchange transactions as those transaction where the '*entity receives value <u>without</u> directly giving approximately equal value in exchange*'. This includes cash transfers. Under IPSAS 23, conditions must include a "use or return" requirement. The entity is required to return resources to the donor where the conditions are not met. Restrictions are stipulations that do not have this use or return requirement. Where conditions are attached to a cash transfer a liability is recognised. This represents the present obligation that arises because of the conditions. Where restrictions are attached to a cash transfer, no liability is recognised, and revenue is recognised immediately. The main difference between IPSAS 23 and IFRS for SMEs is that IPSAS 23 requires there to be a use or return requirement for a stipulation to be a condition; IFRS for SMEs does not.

3.7 IAS 20 provides guidance that stipulations requiring funds to be returned to the donor if a specified future event occurs are restrictions and do not affect initial recognition. IAS 20 requires the occurrence of the future event (for example, an NPO ceasing to use the asset as intended) to be treated as a change in accounting estimate. IPSAS 23 includes similar guidance, noting that in the case of future events, "a return obligation does not arise until such time as it is expected that the stipulation will be breached." IFRS for SMEs includes much less guidance that IAS 20 or IPSAS 23 and does not address this issue.

3.8 IFRS 15, *Revenue from Contracts with Customers*, was issued in 2014. Under IFRS 15, revenue is recognised when an entity satisfies performance obligations. While this standard only addresses exchanges transactions, the IPSASB has considered how the principles can be extended to non-exchange transactions such as cash transfers with conditions.

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[3] IFRS for SMEs draws on IAS 18 *Revenue* in its treatment of exchange transactions

[4] This standard pre-dates the current IFRS conceptual framework and is not consistent with its principles.

3.9 The IPSASB has recently published ED 70, *Revenue with Performance Obligations*, and ED 71, *Revenue without Performance Obligations*. Under these proposals, cash transfers with conditions to provide goods or services to the public would be accounted for under ED 70, which is based on IFRS 15. Other cash transfers would be accounted for under ED 71. Revenue would be recognised when any conditions are met, with a liability recognised until this point. Unlike IPSAS 23, ED 71 does not require there to be a use or return requirement before revenue is deferred. In this respect, the proposals in ED 71 and the requirements in IFRS for SMEs are similar - revenue can be deferred in a wider range of circumstances. ED 71 explicitly addresses cash transfers to acquire or construct a capital asset. It proposes that revenue from such cash transfers would be recognised as the asset is either procured or constructed.

3.10 All standards require the initial measurement of revenue to be based on fair value. Fair value, which takes into account any discounting required to reflect the time value of money, may be ascertained by reference to an active market or by appraisal.

4. National-level guidance

4.1 Annex A shows different approaches to the treatment of cash transfers in national-level guidance, which shows some divergence of approaches in international standards. Where national standard setters follow either IFRS or IPSAS standards the principles established in section three above largely apply in national standards. National standard setters can be converged on IFRS, IFRS for SMEs or IPSAS.

4.2 One national standard setter provides guidance that is generally converged with IFRS for SMEs, with some additional options based on IFRS. The guidance covers government grants, which can be accounted for using either the accrual model (based on IAS 20) or the performance model (based on IFRS for SMEs). Guidance is also provided on other non-exchange revenue; this guidance follows the performance model in IFRS for SMEs. This may result in government grants and cash transfers from other sources having different accounting treatments. To avoid this inconsistency, some sector specific guidance disallows the use of the accrual model.

4.3 One national standard setter provides guidance that is generally converged with IFRS. Additional guidance is provided on the application of IFRS 15 to NPOs, particularly where services are provided to third-party beneficiaries. Additional guidance is provided on non-exchange revenue, which is recognised immediately except where the transaction requires the NPO to acquire or construct a non-financial asset. In these circumstances, revenue is recognised as the entity satisfies the conditions attached to the transfer (i.e., as the asset is acquired or constructed).

4.4 One national standard setter provides guidance for NPOs based on size. Guidance for the larger organisations is generally converged with IPSAS, with some additional guidance for NPOs included. Simplified guidance is provided for smaller organisations, but follows the principles in IPSAS 23;

that is cash transfers are recognised immediately unless there are conditions including a use or return requirement.

4.5 Two national standard setters have developed national standards that are not based on international standards. In both cases, revenue is recognised immediately where the cash transfer does not include conditions. Where the cash transfer does include conditions, one standard setter defers revenue recognition only where a use or return requirement is attached to the condition. This approach is similar to that in IPSAS 23; however, net assets with donor restrictions (i.e., where there is no use or return requirement) must be presented separately from net assets without restrictions.

4.6 The second national standard setter permits contributions with stipulations to be recognised using a deferral method, where the contributions are recognised in the period related to the expenses. This approach is similar to that in IAS 20 (where the cash transfer is not related to an asset). An alternative approach is permitted where revenue is recognised immediately but is identified as part of a separate restricted fund, which will also show the related expenses. This national standard setter is currently reviewing their guidance on contributions, although no conclusions have been reached to date.

5. Alternative financial reporting treatments

5.1 Both international and national accounting standards adopt the same recognition and measurement principles for revenue. Where a cash transfer does not include conditions, revenue is recognised immediately in all cases. Stipulations requiring an NPO to repay funds where a specified future event occurs do not affect the initial recognition of revenue. These approaches are adopted in all the alternatives. Cash transfers are initially measured at fair value.

5.2 IFRS and IFRS for SMEs include accounting requirements for government grants that could lead to inconsistent accounting requirements for cash transfers depending on the donor. Alternative four proposes extending the requirements for government grants to all cash transfers, in line with some national accounting standards.

5.3 Alternative three, based IAS 20 pre-dates the current IFRS Conceptual Framework and is not consistent with its principles. For that reason, the Technical Advisory Group has advised that this alternative should not be pursued, but that feedback should be requested, in order to understand if this has significant support from stakeholders, and, if so, the basis for that support.

	Description	Advantages	Disadvantages
Alternative 1 – Use existing international standards with additional NPO specific guidance **1 a) IFRS for SMEs** **1 b) IFRS suite of standards** **1c) IPSAS**	For all • Additional NPO specific guidance and examples including presentation of restricted funds 1 a) IFRS for SMEs • Revenue from government grants with conditions is recognised as conditions are met • Detailed disclosure requirements for government grants only 1 b) IFRS suite of standards • Revenue from government grants with conditions can be recognised systematically to match expenditure or grants can be netted from the cost of a capital asset. • Detailed disclosure requirements for government grants only	For all • Cost-effective if retaining existing basis of revenue accounting. • Specific guidance to assist NPOs in their potentially complex arrangements and to address materiality and cost/benefit. • Presentation requirements for cash transfers with restrictions provides transparency. 1 a) IFRS for SMEs • Potential for higher current use amongst existing preparers and therefore least change 1 b) IFRS suite of standards • No change for those currently using this suite of standards	For all • Determining when conditions have been met may be complex. • NPOs may not have the systems required to monitor performance, increasing costs and additional disclosure may be more costly. • Moving to another suite of standards as a basis of revenue accounting could be costly. 1 a) IFRS for SMEs • Only covers government grants and not all non-exchange transactions • The treatment of government grants is inconsistent with grants from other providers 1 b) IFRS suite of standards • Only covers government grants and not all non-exchange transactions • IAS 20 is not aligned with the conceptual framework and the treatment of government grants is inconsistent with grants from other providers • Allows netting off of grants for capital assets and therefore inconsistent with gross reporting

	Description	Advantages	Disadvantages
	1 c) IPSAS • Revenue from cash transfers (including donations, and grants) with conditions is recognised as conditions (including use or return obligations) are met • Detailed disclosure requirements for all cash transfers outlined in the standards	1 c) IPSAS • Standards for exchange and non-exchange transactions have been developed together and so there are no gaps	1 c) IPSAS • Existing disclosure requirements may be more extensive than proposals in additional guidance and may be more costly to implement.
Alternative 2 – Use IFRS for SMEs for exchange transactions and require the use of ED71 *Revenue without performance obligations* for non-exchange transactions	• Revenue from cash transfers with conditions is recognised when the conditions are met, whether the cash transfer is in respect of an asset or not. • A requirement to return funds where a specified future event occurs does not affect initial recognition of revenue. • Specific presentation requirements for cash transfers with restrictions. • Additional NPO specific guidance and examples.	• Specific guidance to assist NPOs in their potentially complex arrangements and to address materiality and cost/benefit. • Presentation requirements for cash transfers with restrictions provides greater transparency. • Transparency regarding an NPO's ability to utilise transfers. • Increased consistency in the presentation of financial information	• Determining when conditions have been met may be complex. • Gaps or overlaps between IFRS for SMEs and ED71 • NPOs may not have the systems required to monitor performance, increasing costs and additional disclosure may be more costly.

Alternative 3 – Recognise revenue on a systematic basis over the periods in which the entity recognises the related costs for which the cash transfers are intended to compensate	• Recognition of revenue from cash transfers with conditions on a systematic basis over the periods in which the related costs are recognised. • Revenue related to assets recognised by setting up deferred revenue. • A requirement to return funds if a specified future event occurs does not affect initial recognition of revenue. • Specific presentation requirements, guidance and examples including the presentation of restricted funds.	• Consistent with principles in IAS20 and therefore simple for IFRS adopters to implement (but less robust technically than Alternatives 2 or 3). • Simple to operate and may be less costly in the longer term than alternatives that require reassessment of individual transactions.	• Inconsistent with IFRS for SMEs, IPSAS and the IFRS Conceptual Framework. • Deferred income relating to an asset may not reflect the NPO's true financial position. • Matching recognition of revenue with related costs may not reflect the NPO's true financial position. • Conceptual differences may lead to lack of consistency and transparency of financial reporting within and between entities.

Specific Matters for Comment

Do you agree that the list of alternative treatments that should be considered is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.

Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment? If you do not agree, please set out the changes you propose, and why these should be made.

Please identify the alternative treatment that you favour, and the reasons for your view.

[Draft generic questions for further discussion]

Annex A – Cash Transfers

	IFRS and IPSAS	UK	Australia	New Zealand	Canada	USA
Alternative 1 –Use existing international standards with additional NPO specific guidance **1 a) IFRS for SMEs** **1 b) IFRS suite of standards (IAS 20)** **1c) IPSAS (ED 71)**	IFRS including IFRS for SMEs do not provide guidance on cash transfers except for government grants. IAS 20 allows government grants to be netted from the cost of a capital asset or deferred. Revenue from cash transfers with conditions is recognised: as conditions are met (IFRS for SMEs):as conditions (including use or return obligations) are met (IPSAS 23); or systematically to match expenditure (IAS 20).	1a) FRS 102 permits revenue from government grants with conditions to be recognised systematically to match expenditure (consistent with IAS 20) or as conditions are met (consistent with IFRS for SMEs). Permitted option for government grants (but not other non-exchange revenue) in FRS 102. Modified 1a) However, this option is not permitted in the Charities SORP.	Modified 1b) Under AASB 1058, where a cash transfer includes a condition that the NPO acquire or construct a non-financial asset, revenue is recognised as the NPO meets the condition. Under AASB 1058, all other non-exchange revenue is recognised immediately.	1c) PBE IPSAS 23 permits revenue to be deferred only where there is a condition, which always includes a "use or return" requirement. In all other cases, revenue is recognised immediately. Modified 1c) Under PBE IPSAS 23 and PBE SFR A NFP, revenue from cash transfers with conditions (that include a use or return requirement) is recognised as the conditions are met.		
Alternative 2 – Use IFRS for SMEs for exchange transactions						Section 958-605-25 permits revenue recognition to be

	IFRS and IPSAS	UK	Australia	New Zealand	Canada	USA
and require the use of ED71 *Revenue without performance obligations* for non-exchange transactions						deferred only where there is a condition, which must include a user or return requirement.
Alternative 3 – Recognise revenue on a systematic basis over the periods in which the entity recognises the related costs for which the cash transfers are intended to compensate	Under IAS 20, revenue from cash transfers with conditions recognised systematically to match expenditure, or over the life of an asset.				Section 4410 of the Accounting Handbook includes the deferral method, where the contributions are recognised in the period related to the expenses.	
Standards References	IFRS for SMEs sections 23 and 24, IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*, ED 70, *Revenue with Performance Obligations*, ED 71, *Revenue without Performance Obligations*, IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.	FRS 102 Section 24 *Government Grants*, FRS 102 Section 34 *Incoming Resources from Non-exchange Transactions*, Charities SORP (FRS 102) (Second Edition) Section 5 *Recognition of income, including legacies, grants and contract income.*	AASB 15 *Revenue from Contracts with Customers* AASB 1058 *Income of Not-For-Profit Entities*	PBE IPSAS 23 *Revenue from Non-Exchange Transactions* for Tier 1 and 2 entities PBE SFR A NFP, *Public Benefit Entity Simple Format Reporting – Accrual (Not-for-Profit)* for Tier 3 entities.	CPA Canada Handbook - Accounting, Section 4410, *Contributions – revenue recognition* and the CPA Canada Public Sector Accounting Handbook, PS 4210, *Contributions – revenue recognition*	Accounting Standards Codification (ASC) 958-605-25 (Recognition) 958-605-30 (Initial measurement) 958-605-35 (Subsequent measurement) 958-605-45 (Other presentation matters)