International Financial Reporting for Non Profit Organizations

Technical Advisory Group

AGENDA ITEM: TAGCP04-03
January 7, 2020 – Virtual Meeting

Grant expenses

Summary	The accounting treatment for grant expenses 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 • The list of alternatives to address the issue • Links to other international standard development, national standards or other guidance • The need for any further input

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Grant Expenses

1. **Consultation Paper Draft**

1.1 At the TAG meeting on November 4, the TAG agreed that accounting for grant expenses should be included in the short list of issues to be included in the Consultation Paper.

1.2 In this paper the term 'non exchange' is used where the grantor provides a grant and does not receive a specific good or service from which it benefits in return. In other literature the term 'non reciprocal' is used.

Question 1: Does the TAG have a view on the terminology used to describe such transaction?

1.3 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 2: What comments does the TAG have on Sections 1 and 2?

Question 3: 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 grant expenses issued by national standard setters or other regulatory bodies that should be included in the Consultation Paper?

Question 4: Does the TAG agree with the descriptions of the alternatives, their respective advantages and disadvantages, and that they should be included in the Consultation Paper?

Question 5: What comments does the TAG have on the standard 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 6: Is there specific input to be sought from the PAG?

December 2019

Part 2 - Draft Consultation Paper Text

Grant expenses

1. Description of the issue

1.1 NPOs can award grants to other NPOs, entities or individuals. Grants can be purely cash or comprise cash and other assets. Grants may take the form of a "promise to pay", potentially over multiple reporting periods rather than the immediate transfer of cash to the recipient.

1.2 The giving of grants can be complex, involving multiple agencies. For example, one NPO may give a grant to another NPO, who may in turn give another grant, with only the final recipient providing specific services to beneficiaries or meeting the stipulations to be in receipt of the grant. These types of arrangements are in themselves complicated but depending on the arrangements create separate obligations to each grant awarding body and thus different recognition points for grant expenses and can impact on measurement.

1.3 A grant may include one or more obligations on the recipient to perform either specific or generic activities before they are entitled to receive the grant. For example, a grant may be given to provide health services for a period (generic activities) or to carry out a number of inoculations to school children (specific). Under both scenarios there may be questions for the grantor as to whether and when all or part of the grant expense should be reflected in the accounts.

1.4 At the end of a grant awarding period there can be a significant period of time before it is certain that the recipients of the grant have met all of the conditions and the grant awarding body certifies completion of a specific grant or project. This can lead to uncertainty of recognition for accounts preparers.

1.5 Guidance can be beneficial for accounts preparers, providing clarity on the financial reporting issues that can arise for these multiple reasons, particularly where these grants are awarded through complex organisation arrangements or over time. It also benefits donors and other stakeholders who wish to have a clear understanding of the expenses, obligations and commitments of an NPO.

2. Financial reporting challenges

2.1 The accounting treatment of grant expenses can be a significant issue for NPOs particularly as they are likely to be non-exchange transactions which aren't covered explicitly in international accounting standards.

2.2 Difficulties also arise because it is not always clear what an NPO (grantor) has committed to i.e. what it has promised to the grant recipient and what obligations have been created.

2.3 As grants can be awarded over multiple financial reporting periods an NPO will need to consider whether the whole amount should be recognised immediately or in each reporting period for which the grant is intended. Also measurement issues may arise where the time value of money is significant.

2.4 A further challenge arises from an understanding of where an NPO's obligations might end and the impact of performance against grant conditions. For example, if an entity does not comply with the conditions questions are likely to arise as to whether an obligation to pay the grant continues to exist.

2.5 Particular issues can occur when the grant is paid before conditions are met. There might be two different circumstances:

- Conditions relate to how the grant is spent – in these cases the grantor will need to assess whether the conditions are met (which might take place in stages).

- Conditions relate to how items acquired by the grantee for the purposes of the grant programme continue to be used or if items are sold.

2.6 These conditions might apply to how a grant is applied or how assets acquired by applying a grant continue to be used. The latter conditions are less common and it is not normally the case that an awarding body includes return conditions or stipulations. The accounting for such transactions would normally create a separate transaction where the NPO may need to take action (and create a new liability) to recognise any return obligation.

2.7 The circumstances outlined above will exist whether the relationship from grantor to recipient is direct (i.e. from grantor to recipient) or indirect (i.e. from grantor NPO, to an intermediate NPO to the recipient). However, this makes the transactions more complex and identifying the obligating event between the parties to recognise the grant expense more challenging. Additionally, where such circumstances exist the intermediate NPO will need to consider whether it is acting as agent in the transaction or whether it is acting as principal in awarding the grant to the recipient.

2.8 The presentation of grants in the income and expenditure statement need to be considered in the context of either a nature of expense or a functional analysis of expenditure. Consideration also needs to be given to disclosures about any commitments, which are not yet reflected in the accounts, particularly for grant making NPOs.

3. Current international guidance

3.1 Currently international guidance does not explicitly deal with grant expenses/expenditure. As a consequence current guidance rests under the general provisions of IFRS, IFRS for SMEs and IPSAS, for the recognition of provisions and the reporting of and contingent liabilities:

- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- Section 21 Provisions and Contingencies – *IFRS for SMEs*
- IPSAS 19 *Provisions, Contingent Liabilities and Assets*.

3.2 Under these standards an expense for a grant and a liability would be recognised when an NPO has a present obligation to fund another entity created by a past event i.e. a commitment (or a constructive obligation) and the amount of the grant can be measured. Recognition of the grant would take place when an NPO has no realistic alternative other than to settle an obligation to pay the grant (and it is therefore probable that there will be an outflow of resources). When the expense is recognised it follows the relevant standards requirements for presentation, measurement and disclosure of the expense and cross reference needs to be made to nature/function of expenses.

3.3 Under these standards the timing of the recognition of the grant would be dependent on any conditions included in the grant (i.e. when the conditions are such that there would be no realistic alternative to settling the obligation to pay the grant). If there are no conditions and an obligation has been created then the grant would need to be recognised as an expense in the reporting period. Where the time value of money is significant the grant would need to be recognised at present value.

3.4 As the current guidance does not explicitly address non-exchange transactions, particularly for grant expenses, the existing standards do not provide specific guidance to cover performance obligations imposed by a grantor, nor the timing of recognition of obligations when a grantor has agreed to make a grant.

3.5 IPSASB has a current project on Transfer Expenses which would explicitly provide guidance for such transactions. The draft of the Exposure Draft which was considered by IPSASB at its 10 December 2019 meeting defines a transfer expense as:

'…a *transaction in which an entity provides a good, service, or other asset to another entity (which may be an individual) without receiving any good, service, or other asset in return...*

3.6 The proposed text addresses recognition and measurement of performance obligations, distinguishing between where the transfer recipient is required to satisfy performance obligations by transferring goods or services to a third-party beneficiary and where the transfer recipient is not required to satisfy performance obligations. Through this text it also addresses multi-year grants. In addition, the proposed text addresses the presentation and disclosure requirements. The Exposure Draft is due to be issued in the first quarter of 2020.

4. National-level guidance

4.1 A number of the jurisdictions follow international standards i.e. either IFRS or IPSASB provisions following the accounting treatments for the recognition of the grants as outlined above in section 3.

4.2 Other national level guidance though based on the same or similar provisions provides additional guidance. One set of national guidance takes the general approach to the recognition of liabilities/provisions for grantors, but also explicitly includes the concept of performance obligations.

4.3 This national GAAP requires a liability and an expense to be recognised when a commitment has been made as long as the definition and recognition criteria for a liability have been satisfied, the obligation is such that the entity cannot realistically withdraw from it, and the entitlement of the other party does not depend on performance-related conditions.

4.4 Another national GAAP has issued guidance on how to account for contributions made and received. It defines a promise to give as a written or oral agreement to contribute cash or assets to another entity. A promise to give may be either conditional or unconditional. Contributions made are recognised as expenses in the period made and as decreases of assets or increases of liabilities depending on the form of the benefits given.

4.5 This national GAAP requires an NPO to decide whether the transaction is an exchange transaction. If it is not, then the next decision is to consider whether the transaction has imposed a condition on the recipient or whether it is unconditional. If it is conditional it would need to be recognised when the conditions are met. If it is unconditional it is recognised in the reporting period as an expense. A liability would be recognised when the grant/ promise is unconditional. This is unless an asset has actually been transferred, in which case the grantor would record an asset (i.e. an advance receivable) until the conditions are met.

5. Alternative financial reporting treatments

5.1 Largely both international GAAP and national GAAP require an entity to recognise a liability and an expense when a grantor is committed to provide resources to the recipient (individual, organisation or entity).

5.2 Some national GAAPs explicitly include provisions on performance obligations or where the grant is conditional or has conditions that need to be met.

5.3 The alternatives in the table below consider alternatives based on national and international GAAP and the principles being developed in the new IPSASB standard.

	Description	Advantages	Disadvantages
Alternative 1 – Follow international accounting standards with no additional guidance.	• Recognise a liability and an expense for the grant when an obligation has been created.	• No change to additional requirements of international accounting standards so easy to implement.	• Does not explicitly address the issues identified by the sector.
Alternative 2 – Follow the international GAAP and include additional guidance on recognition, measurement and disclosure including performance related conditions.	• Recognise a liability and an expense for the grant when an obligation has been created. • Provide additional guidance on performance related conditions. • Provide additional guidance on multi-year grants. • Provide guidance on the disclosure of grants and related commitments.	• Builds on existing international standards. • Additional guidance will provide relevant information to allow NPOs to decide when it has an obligation to pay the grant. • The additional guidance may assist NPOs with their decision making process relating to the recognition of expenses for multi-year schemes. • Transparency of commitments made by giving grants in future years.	• May require additional processes and activities to build the records needed to prepare the information to support decision making and disclosures. • Potential for additional audit time and costs.

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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 – Grant Expenses - Analysis to support alternatives

	IFRS and IPSAS	UK	Australia	New Zealand	Canada	USA
Alternative 1 – Follow international accounting standards with no additional guidance.	IFRS and IPSAS and IFRS for SMEs require a liability and an expense for a grant to be recognised when a grantor has a present obligation to fund another entity/ individual created by a past event. Expenses are then recognised, measured and presented in accordance with the presentation of financial statements standards.		Follows IFRS.	Follows IPSAS for Tier 1 and Tier 2 entities. Additional illustrative guidance is also provided.	Accounting standards on the recognition of provisions etc. are similar in Canada but there is no specific guidance on accounting for grant expenditure.	

Alternative 2 – Follow the international GAAP and include additional guidance on recognition, measurement and disclosure including performance related conditions.		The UK position generally follows IFRS but includes specific provisions on performance obligations and disclosure. The Charities SORP provides more detailed examples of practical application. Disclosures of any unrestricted funds designated to fund future commitments is also required.		For Tier 3 PBE Simple Format Reporting – Accrual (Not-for-profit) Standard includes requirements/guidance for accounting for grant expenses.		A liability would be recognised when the grant/ promise is unconditional. Conditional grants/ promises would be disclosed only. This is unless an asset has actually been transferred, in which case the NFP would record an asset (advance receivable) until the conditions are met. Note that since the guidance parallels that for the recipient side of the transaction, and there is thus much cross-reference to those provisions.

Standards References	IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets, IFRS for SMEs, Section 21. IAS 1 & IPSAS 1 Presentation of Financial Statements. IFRS for SMEs sections 3 and 5*	FRS 102 paragraphs 34.57 to 34.63 and Appendix A to Section 34 and Charities SORP paragraphs 7.5 to 7.34 and 7.43 to 7.46.	AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*	PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*		FASB ASC 958-720 Not-for-Profit Entities Other Expenses, 958-405 Not-for-Profit Liabilities, 958-405-45 Other Presentation Matters, and 958-405-50 Disclosure (including glossary entries).