Practitioner Advisory Group Issue Paper

AGENDA ITEM: PAGED08-02
14 December 2022 – Online

Grant Expenses

Summary	This paper outlines some of the key conceptual issues for the development of INPAG relating to Grant Expenses and seeks PAG views on practical considerations for NPOs associated with them.
Purpose/Objective of the paper	To provide PAG members with an overview of the conceptual basis for the recognition and measurement of grant expenses. To give PAG members the opportunity to advise on the practical considerations identified to date and highlight any additional areas on which guidance is required.
Other supporting items	None
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Actions for this meeting	Provide advice on: • the proposed terminology for the recognition of grant expenses; • practical issues NPOs may face in applying the conceptual approach in various situations; • additional recognition and measurement guidance that may be required; and • practical issues that NPOs may face complying with the disclosure requirements, and any additional disclosures required.

The Chartered Institute of Public Finance & Accountancy

Practitioner Advisory Group

Grant Expenses

1. Consultation Paper proposals and responses

1.1 The recognition and measurement of grant expenses was identified as a specific issue for non-profit organisations and a number of financial reporting challenges were highlighted in the Consultation Paper. These included that difficulties arise because it is not always clear what has been promised to a grant recipient and what commitments have been created, and that significant judgement may be required to determine when a grant expense should be recognised. Grant expenses are not currently explicitly covered in international accounting standards.

1.2 The Consultation Paper proposed two alternative financial reporting treatments for developing guidance for accounting for grant expenses. These were:

- Alternative 1, based on the international framework used as the basis for INPAG (now determined to be the *IFRS for SMEs* Accounting Standard) with additional guidance to assist NPOs with NPO-specific issues. This would include recommended additional disclosures; and
- Alternative 2, which builds on alternative 1 but requires that the principles being proposed in IPSAS ED 72 *Transfer Expenses* (hereafter IPSAS ED 72) are incorporated. Incorporating these principles would provide additional guidance on grants with performance obligations and multi-year arrangements.

1.3 At TAG ED 08, TAG members discussed the summary of responses to the grant expenses section of the Consultation Paper (see Appendix for detailed responses to Significant Matters for Comment). Specific comments from respondents included a need to recognise that some grants may be given in-kind, that consistency with revenue accounting was important, that grant arrangements needed to be distinguished from procurement arrangements, and that non-performance related conditions such as time conditions were important.

1.4 The TAG were advised that Alternative 2 received the most support from respondents to the Consultation Paper. In light of the responses, the TAG agreed that the Secretariat develop grant expenses financial reporting guidance for NPOs based on the principles contained within the IPSASB's ED72.

2. Proposed conceptual approach to grant expenses based on IPSAS ED 72

2.1 Since IPSAS ED 72 was developed, IPSASB has made a number of changes to its proposals, mostly to simplify the requirements and ensure consistency of terminology with its concurrent proposals on revenue.

2.2 A proposed conceptual approach to grant expenses based on the latest proposals from IPSASB, which are themselves based on IPSAS ED 72, have been developed and will be discussed with the TAG at its January 2023 meeting. A high level summary of this approach is provided below.

What is a grant expense?

2.3 A **grant expense** is an expense arising from a transaction in which a **grant providing NPO** provides assistance to a **grant recipient** (which may be an entity or individual) by transferring cash or a service, good or other asset to that **grant recipient** without directly receiving any cash, service, good or other asset in return.

What is a binding grant arrangement?

2.4 **Grant expenses** will often but not always arise from **binding grant arrangements**. These are grant arrangements that confer both rights and obligations, enforceable through legal or equivalent means, on the parties to the grant arrangement. While it is expected that this will usually be through a written grant agreement, it could also arise through an oral agreement or be implied by an NPO's or a sector's customary practices.

Grant expenses where there is no binding grant arrangement

2.5 In the absence of a **binding grant arrangement** the **grant providing NPO** may recognise **grant expenses** either because (i) a constructive or legal obligation exists to transfer resources which results in the recognition of a provision, or (ii) the **grant providing NPO** otherwise ceases to control economic resources by transferring them to the **grant recipient**, for example by making a cash payment or transferring an asset.

Grant expenses where there is a binding grant arrangement

2.6 Where there is a **binding grant arrangement** a **grant providing NPO** will need to identify each distinct right in the arrangement that the **grant recipient** has to satisfy, and determine how much of the grant is associated with each of these distinct **grant satisfaction rights**. This will allocate the **grant payment consideration**. For the grant recipient this will create a **compliance obligation**.

2.7 The **grant providing NPO** will recognise a **grant expense** when a **grant satisfaction right is extinguished** – in other words the obligation in the agreement has been met. It will be measured at the amount of the **grant payment consideration** allocated to that distinct **grant satisfaction right**.

2.8 If the **grant providing NPO** has transferred resources to the **grant recipient** in advance of the grant recipient satisfying its **compliance obligations**, the **grant providing NPO** will derecognise the transferred resources and recognise a **grant prepayment asset**. The **grant expense** will be recognised when the **grant prepayment asset** is derecognised because the **grant recipient** has satisfied its **compliance obligations**.

2.9 If the **grant recipient** has satisfied its **compliance obligation** prior to **the grant providing NPO** transferring resources, this will give rise to a grant payment obligation and the recognition of a **grant payment liability**. Recognition of this liability will also lead to the recognition of a **grant expense**. The liability will be derecognised when the resources are transferred to the **grant recipient**.

Question 1: Does the PAG have any comments on the proposed terminology for the recognition of grant expenses? In particular does the PAG have any comments on:

- Grant expense
- Binding grant arrangement
- Grant payment consideration
- Compliance obligation
- Grant satisfaction rights
- Extinguished grant satisfaction right

3. Practical considerations associated with the proposed conceptual approach for NPOs

3.1 There are a number of practical considerations associated with the proposed conceptual approach for NPOs on which the PAG's views are sought. These are primarily focused on how the guidance will be implemented by NPOs in various situations. Those that are covered in the draft authoritative guidance are highlighted below. PAG members are invited to consider any practical implications NPOs may face in complying with guidance that includes these requirements.

Principal agent considerations – NPOs acting on behalf of other entities

3.2 It was agreed with the TAG at its September 2022 meeting that guidance on situations where an NPO is acting on behalf of other entities will be integrated into those Sections where guidance on principal agent relationships is needed. One of these Sections is grant expenses.

3.3 If the grant providing NPO controls the economic resources that are transferred to the grant recipient, it will be a principal in the transaction and apply the grant expenses guidance. This is the case even if the grant expenses arise from a binding grant arrangement imposes obligations upon the grant providing NPO. If the grant providing NPO ultimately has discretion over the amounts and timing of the transaction, the identity of the grant recipient, and the conditions under which the transaction is to occur it has control and is a principal in the transaction.

3.4 If it does not control the resources it will be acting as an agent, In this case it will be merely transferring cash or other assets to a grant recipient on behalf of another entity. If this is the case it will not recognise grant expenses. Instead it will recognise only the costs it incurs in the administration of the agency arrangement.

Variable consideration

3.5 The grant payment consideration may vary for items such as incentives or penalties, or because the grant providing NPO's obligation to provide the resources is contingent on the occurrence or non-occurrence of a future event. For example, more funds may become payable to the grant recipient if it satisfies its compliance obligations within a specified period. This is known as variable consideration. Where there is variable consideration this may result in a liability of uncertain timing or amount, and if it is probable that a present obligation exists, the grant providing NPO will need to estimate the amount of variable consideration and recognise a provision and grant expense.

Changes to the grant payment consideration and/or to the binding grant arrangement

3.6 The grant payment consideration may change because, for example, uncertain events are resolved. If this happens the grant providing NPO may need to change amounts allocated to a grant satisfaction right that has already been met, requiring an additional expense or the reduction of an expense. There may also be modifications to the binding grant arrangement that change rights and obligations. This may lead to a calculation of an accumulated grant expense that differs to the accumulated grant expense previously recognised and require an adjustment through surplus and deficit.

Performance-related rights and obligations

3.7 Binding grant arrangements may contain performance-related rights and obligations, such as payment being conditional on a specific level of service or varying depending on units of output. Where this results in variable consideration, a provision and associated grant expense may need to be recognised.

Restricted grants

3.8 A binding grant arrangement that restricts a grant to a particular purpose does not on its own create a performance-related right or obligation as the payment is not conditional on a specific level of service or outputs by the grant recipient.

Capital grants

3.9 A capital grant will occur where under a binding grant arrangement a grant providing NPO transfers cash or another asset to a grant recipient with a specification that the grant recipient acquires or constructs a non-financial asset that the grant recipient will then control.

3.10 A grant providing NPO shall follow the same approach to recognising a grant expense for a binding arrangement involving a capital grant as with any other grant expense. If the grant recipient acquires the specific non-financial asset, the grant providing NPOs grant satisfaction right will be extinguished when the asset is acquired and a grant expense will be recognised by the grant providing NPO at this point. If the grant recipient constructs the non-financial asset, the grant satisfaction right will be extinguished as the asset is being built, with a grant expense recognised by the grant providing NPO based on the measure of progress made by the grant recipient.

3.11 If the grant recipient acquires or constructs the asset prior to the transfer of resources from the grant providing NPO, the grant providing NPO will recognise a grant payment liability and a grant expense for the obligation to transfer resources. This could be for the full amount if the asset is acquired or based on the extent of progress towards constructing the asset.

Question 2: What practical issues do the PAG consider grant giving NPOs might face in relation to recognising and measuring a grant expense, for example in:

(i) determining variable consideration including when there are performance related rights and obligations?
(ii) dealing with changes to the grant payment consideration and/or the binding grant arrangement?
(iii) applying recognition and measurement principles to capital grants, in particular determining when a grant recipient has purchased an asset or measuring the progress it has made to construct an asset?
(iv) understanding the difference between restrictions and performance-related rights and obligations?

Reclassification and impairment of a grant prepayment asset

3.12 A grant recipient may become unable or unwilling to satisfy its compliance obligations under the binding grant arrangement after the grant providing NPO has recognised a grant prepayment asset. If the grant providing NPO has an enforceable and unconditional right to a refund of the previously transferred cash arising from the terms of the binding grant arrangement, the legal system in the jurisdiction, or other circumstances, the grant providing NPO will need to reclassify the grant prepayment asset to a financial asset and measure it as such. This is because the transaction has moved from being a prepayment to being a debtor. If the grant providing NPO does not have an enforceable and unconditional right to a refund it will need to assess the grant prepayment asset for impairment.

Payments of grant over more than one financial year

3.13 Where the grant payment consideration under a binding grant arrangement is payable over a period of more than one year, a grant payment liability and grant expense will be recognised by the NPO for the total amount of the resources that must be transferred under the binding grant arrangement for the obligations satisfied by the grant recipient.

3.14 Where payments for later years are subject to the grant recipient satisfying obligations that have not yet been met, the NPO may be able to not recognise a grant payment liability and grant expense. This will depend on the terms of the binding grant arrangement to not transfer resources. Also if there are conditions in the binding grant arrangement that remain within the control of the grant providing NPO and this provides it with the discretion that it could and would in practice use to avoid grant expenditure, a liability and grant expense should not be recognised.

3.15 Alternatively, if there are no conditions in the binding grant arrangement that enable the NPO to realistically avoid the transfer of resources, a grant payment liability and grant expense must be recognised for the full grant payment consideration even if payment will occur over a number of financial years.

Grant recipient obligations

3.16 Binding grant arrangements may contain rights and obligations that are outside of the control of the NPO. For example, a transfer of resources by a grant providing NPO may be subject to the grant recipient finding match funding. As this obligation is outside of the control of the grant providing NPO, it will only need to recognise a grant payment liability and grant expense if the transfer of resources is probable.

Question 3: What practical issues do the PAG consider grant giving NPOs might face in recognising and measuring grant related assets and liabilities, for example in:

(i) reclassifying and impairing grant prepayment assets?
(ii) payments of grants over more than one financial year?
(iii) determining liabilities related to grant recipient obligations?

Question 4: What additional guidance could be provided to assist NPOs in complying with the authoritative guidance?

4. Approach to disclosures

4.1 The objective of this Section of the Guidance is for a grant providing NPO to disclose sufficient information to enable the users of the general purpose financial reports to understand the nature, amount, timing and uncertainty arising from grant expenses. This will include a description of the purpose of the binding grant arrangements or other arrangements that have led to the recognition of grant expenses, significant payment terms, and the nature of the resources that have been or will be transferred. PAG views are sought on the presentation and disclosure of grant expenses.

4.2 For specific financial statement items, where material, it is proposed that a grant providing NPO will need to disclose:

Grant expenses –an analysis of grant expenses in accordance with the to be determined classification of expenses requirements.

Grant prepayment assets and financial assets – information that enables users to understand balances, and significant judgements and changes in significant judgements that the grant providing NPO has made regarding the recognition of grant prepayment assets. The grant providing NPO will also need to disclose significant risks and uncertainties relating to the realisation of grant prepayment assets. As the grant prepayment asset is not a financial asset under the *IFRS for SMEs* Accounting Standard, consideration will be given to amending Section 11 *Financial Instruments* to create a specific grant prepayment asset category which will permit the broader disclosure requirements of that Section to apply. Where the grant prepayment asset has been reclassified as a financial asset this will be disclosed as a financial instrument in accordance with Section 11 *Financial Instruments* .

Grant payment liabilities and provisions - If the grant payment liability is an obligation to transfer cash, it is disclosed as a financial liability. If the grant payment liability is not an obligation to transfer cash, the NPO will need to disclose the nature of the obligation and the resources that will need to be transferred to satisfy the obligation. As with grant prepayment assets, consideration will be given to amending Section 11 *Financial Instruments* to create a specific category for grant payment liabilities that are not obligations to transfer cash. If variable consideration has resulted in the recognition of a provision, the provision disclosure requirements will be applicable.

Contingent grant payment liability - the disclosure of the existence of a commitment by a grant providing NPO to provide grant funding that is not recognised as a grant payment liability or provision because a transfer of resources is possible but not probable.

Principal agent considerations – disclosures required will include:

(i) an analysis of funds received and paid by the NPO as an agent;
(ii) details of any balances held as an agent at the reporting date;

(iii) the name and objects of the entity on whose behalf the balances are held and why the NPO is acting as an agent on their behalf;
(iv) details of any balances outstanding between any participating consortium members for which the NPO is administratively responsible;
(v) where funds have been held as agent for related parties the NPO must make the required disclosures for related parties; and
(vi) details of the arrangements for safe custody and segregation of funds and other assets from the NPO's own assets.

Funds with restrictions – where expenses, income, assets, and liabilities recognised relate to a transaction that has been financed by a resource provider that has restricted the financial resources provided to be expended on that specific purpose or activity, these will need to be disclosed in accordance with the funds with restrictions requirements.

Question 5:	Does the PAG have any views on (i) the practical issues that NPOs may face complying with the disclosure requirements and (ii) the disclosures that may be useful to users of the general purpose financial reports?

December 2022

Appendix: Detailed Responses to Specific Matters for Comment

Question	Response	Number	%	% Responded
SMC 4(a) Do you agree with the description of issue 4: Grant expenses? If not, why not?	Agree	29	42%	88%
	Disagree	2	3%	6%
	Neither Agree nor Disagree	2	3%	6%
	Non Response	*36*	*52%*	
TOTAL		69	100%	100%
SMC 4(b) Do you agree that the list of alternative treatments that should be considered for issue 4 is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.	Agree	26	38%	90%
	Disagree	2	3%	7%
	Neither Agree nor Disagree	1	1%	3%
	Non Response	*40*	*58%*	
TOTAL		69	100%	100%

Question	Response	Number	%	% Responded
SMC 4(c) Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment for issue 4? If you do not agree, please set out the changes you propose, and why these should be made.	Agree	26	38%	90%
	Disagree	2	3%	7%
	Neither Agree nor Disagree	1	1%	3%
	Non Response	*40*	*58%*	
TOTAL		69	100%	100%
SMC 4(d) Please identify the alternative treatment that you favour for issue 4, and the reasons for your view.	Alternative 1	8	12%	33%
	Alternative 2	15	22%	63%
	No Preference	1	1%	4%
	Non Response	*45*	*65%*	
TOTAL		69	100%	100%