INTERNATIONAL FINANCIAL REPORTING
FOR NON PROFIT ORGANISATIONS

IFR4NPO Project

Discussion Summary and Requests
Practitioner Advisory Group meeting

14 December 2022
PAGED08

Acronyms

- ED – Exposure Draft
- IFR4NPO – International Financial Reporting for Non Profit Organisations (Project)
- IFRS for SME – International Financial Reporting Standard for Small and Medium Entities (issued by the International Accounting Standards Board)
- INPAG – International Non-Profit Accounting Guidance (the name of the Guidance being developed by the IFR4NPO Project)
- IPSAS – International Public Sector Accounting Standards
- PAG – Practitioner Advisory Group
- SORP – Statement of Recommended Practice

INTERNATIONAL FINANCIAL REPORTING FOR NON PROFIT ORGANISATIONS

Status of this document

- The role of the Practitioner Advisor Group (PAG) is to present the diverse range of perspectives of different users of the guidance that the project aims to develop, giving input to the IFR4NPO Project Team and Technical Advisory Group.
- The PAG is not required to reach consensus and does not make formal decisions or take votes. Opinions shared by individual PAG members are not necessarily those of the entire PAG or the IFR4NPO Project.
- The recording provides a full verbatim account of the views of individual PAG members.
- This document serves to record a summary of key opinions shared in the plenary sessions, in the form of a discussion digest, and requests to or from PAG members.
- This document should be read in conjunction with the meeting papers and questions available here.

Attendance

Notes

The meeting was held online, chaired by Tim Boyes-Watson, and attended IFR4NPO Project team members Samantha Musoke, Karen Sanderson, Paul Mason and Phill Trotter in addition to the following PAG members:

Dorothea Malloy, Karina Vartanova, Kenneth Makanga, Masayuki Deguchi, Nigel Davies, Oumou Wane Toure, Pablo San Martin, Paul Winrow, and Pesh Framjee.

Carolyn Cordery sent apologies but submitted comments in writing.

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Agenda

1. Grant expenses
2. Revenue
3. Outreach for ED1

1.1 Grant expenses – flow chart

- A flow chart was shared during the meeting, which can be viewed from the video meeting video at 05:00
- It was not part of the published PAG papers, and is not reproduced here, but it was prepared informally as a visual aid to facilitate discussion.

1.1 Grant expenses – comments on flow chart

Discussion summary

- Comments from PAG members
  - It would be helpful to see how constructive obligations fit in. A constructive obligation may not be enforceable, but it should result in the recognition of a liability / provision.
  - It is common for grantors to include standard clauses in grant agreements with words to the effect of: 'if we don't have the funds, we will not be liable to pay the grant'. In UK SORP, liabilities associated with grant obligations could be recognised even with this clause, because the grantor is not realistically expecting to withdraw.
  - Total grant consideration is broken down according to discrete 'grant satisfaction rights', separate from the actual tranches of funds that are transferred. Cash transfers will more often relate to a payment plan rather than the satisfaction of rights. This is likely to raise questions.
  - The practicality of measuring a 'satisfaction right' will require guidance, especially in the context of less tangible satisfaction rights on projects that involve advocacy, mediation and peacebuilding.

Requests

- Make space to articulate some context for why this accounting treatment is important. For philanthropic organisations in some countries, there are requirements to 'spend' a certain amount of their endowment each year, in order to retain tax privileges associated with their status,

1.1 Grant expenses – comments on flow chart

Discussion summary

- Comments from PAG members
  - Consider an NPO that has a constructive obligation to make a grant before certain satisfaction rights are fulfilled by the grantee. Presumably, in this case it would require the creation of both a provision and a grant pre-payment asset?
  - It will be important to bring out the aspect of mirroring: do the recognition criteria for a grant maker to recognise a grant expense mirror the criteria for a grant recipient to recognise the income? The current range of practice does not result in mirroring, which means that the whole system is not very coherent.

1.1 Grant expenses – comments on flow chart

Discussion summary

- Comments from the secretariat
  - A constructive obligation can lead to a binding agreement, and this will be explained more fully in the guidance.
  - The Application Guidance under development will include consideration of whether the grantor can realistically avoid the transfer.
  - INPAG will include a number of specific examples to bring examples of 'satisfaction rights' to life.

Requests

- PAG members were requested to share examples of grant agreements with the secretariat.

1.1 Grant expenses - terminology

Discussion summary

- Binding Agreement – comments from members
  - ➢ A member found this term challenging, because it implies legal enforceability, and yet in the case of constructive obligations, such legal enforceability may not exist. A fundamental feature of non-profit accounting is that the decision to pay a grant is ultimately discretionary. Perhaps ‘written’ or ‘formal’ agreement would be more appropriate in this context, where non-legal or non-contractual arrangements are common, but may not meet the general understanding of the term ‘binding’.
  - ➢ Another member noted that many donors use the term ‘binding’ - it is not foreign to NPO world.
  - ➢ It would be helpful to have other examples of equivalent means of enforcing a binding agreement, if not legal.
  - ➢ Vague ‘statements of intent’ or promises to make grants, without even identifying the recipients, or without the recipients having obligations, would not meet the definition of a binding agreement, and should not result in the recognition of a liability.
  - ➢ In the case of multi-year binding arrangements, it is important for grant makers to assess whether they have the liquidity to meet such obligations where funds are not yet dispersed.

1.1 Grant expenses - terminology

Discussion summary

- Binding Agreement – comments from secretariat
  - The prevalence of arrangements that are not binding, makes the accounting more simple, recognising the grant expenditure when the grantor ceases to have control of the resources (usually on payment).
  - The term ‘binding arrangement’ has been drawn from the public sector to describe instances where there are obligations on **both parties**, even though there may not be an enforceable contract.

1.1 Grant expenses - terminology

Discussion summary

- The term 'Grant expenses' could easily be mis-interpreted to mean expenses paid from grants received. An alternative suggestion is 'Grants payable'.
- The definition of grant expenses in paragraph 2.3 says 'by transferring cash' and does not include the aspect of the obligation or liability. The grant expense transaction itself is or will be a transfer of cash, service or good, but may need to be amended to reflect an obligation to transfer.
- The term 'extinguishment of rights' is very legal sounding, and a plainer English alternative such as 'fulfilment' would be preferable.
- The term 'consideration' is foreign and unusual for the sector. If an alternative were available it might be more understandable. Members proposed 'financial support, funding, resources or value' as possible terms to consider.
- Examples of terms used to describe variable consideration arrangements in a grant context were 'full financing mode' and 'flexible financing mode'.

1.2 Grant expenses – practical issues

Discussion summary

- Comments from PAG members
  - The financial statements should make it possible to see if there are obligations to make grants which are not backed up by funds to meet that liability.
  - Principal / agent considerations. Consortia may be with several NPOs or a mix of private and non-profit sector entities. Because of different accounting rules, this can result in confusion with respect to grant expense recognition. Is the prime the principal – should they account for just their part, or the whole transaction?
- Comments from Secretariat
  - It has been decided that aspects relating to agents and principals will be integrated within each relevant section of INPAG rather than a discrete section. It is therefore proposed that the core and application Guidance will include details to cover these types of principal / agent situations.

Requests

- PAG members were requested to share examples of consortia, especially mixed public-private sector, so that the secretariat can text their proposals on these examples.

1.2 Grant expenses – practical issues

Discussion summary

- Comments from PAG members
  - In the context of grants made for the construction of capital assets, Para 3.10 describes recognition on the basis of progress made by the grant recipient in constructing the asset. In the commercial world, this might imply architect's or engineer's reports etc to verify the stage of completion. The wording in 3.10 appears to be looser, and could be interpreted as matching to spend.
  - One member suggested strengthening the language in Para 3.10 to refer to 'reliable measurement' or 'probable costs'. And that the method of measurement should be determined by the grant maker, rather the recipient.
  - In practice, the level of monitoring by the grantor varies between grantors, and according to the perceived level of risk associated with the grantee.
- Comments from the Secretariat
  - Accounting practice in this area (eg recognition on the basis of actual progress / implementation) might drive improved monitoring by grantors, ie 'better behaviour' in the sector, and even help identify / prevent fraud.

Requests

- PAG members requested that the application or implementation guidance include reference to situations where donors retain a residual interest in assets.

1.2 Grant expenses – practical issues

Discussion summary

- Comments from PAG members
  - ➢ Re Para 3.10, in some instances, grantors may retain a residual interest in grant funded capital assets, for example, specifying the asset may only be used on particular programmes or activities, or should be passed on to other entities.
  - ➢ Another example, would be a local authority providing land for a school on the on condition that if the school closed, the land would be returnable. NPOs have made a case for non-recognition of the asset in such cases on the basis of control. But the member argued that such an arrangement should result in recognition of the asset on assuming a going concern basis. Recognition would come down to an assessment of probably about having to return the asset.
  - ➢ The concept of 'right of use' for asset control and recognition may also be relevant in this context.
- Comments from Secretariat
  - ➢ The guidance will make clear that the recognition process in para 3.10 relates only to assets where the grantee controls the asset, which would not be the case where a grantor retains a residual interest in the asset. As well as guidance for treatments where the grantee does not control the assets.

1.2 Grant expenses – practical issues

Discussion summary

- Comments from PAG members
  - With respect to variable consideration – some grantors retain a final payment, which is remitted subject to completion of a project audit and may be reduced by the amount of any ineligible costs identified by the audit process. If funds have already been sent, then ineligible costs may need to be re-imbursed by the grantee. It is relatively common for grantees to make provision for potential ineligible costs, and for grantors to delay recognition of a final amount of grant expense until the audit is finalized. Audits and identification of ineligible expenditure may be up to 5 years after the end of the grant period.
- Comments from Secretariat
  - INPAG will provide guidance for instances such as these. Where ineligible costs are likely, provision would be the appropriate treatment.

Requests

- PAG members were asked to share real world examples of variable consideration.

1.2 Grant expenses – practical issues

Discussion summary

- Comments from PAG members
  - Where there are binding arrangements, if grant expenses are only recognised to the extent that grantees have fulfilled the satisfaction rights associated with the grant, this means that accounting treatment by the grantor is determined by the actions of the grantee. This in turn requires the grantor to obtain verified or verifiable information from the grantee. Yet in practice, the amount of monitoring is often appropriately linked to the level of risk. It would be counter-productive and costly for accounting treatment, rather than risk, to drive the levels of monitoring.
  - One way to avoid this onerous accounting treatment would be to give grants that do not fall into the category of a 'binding arrangement'. The existence or not of a binding arrangement, would often be made on the basis of grant agreements. Such agreements often have standard clauses, which may or may not reflect the result of risk assessments and monitoring arrangements. Indeed, these may even change over the life of the grant.

1.2 Grant expenses – practical issues

Discussion summary

- Comments from PAG members
  - For grantors that need to show a level of spend to maintain status privileges, the time delay between approving and even remitting grants, and being able to recognise the expense, may result in failure to meet such criteria, due to factors outside their own control.
  - One of the criticisms aimed at the non-profit sector is unnecessary or inappropriate (albeit eligible) spending, driven by donor pressure to meet spending targets. Accounting treatment that requires grantees to extinguish satisfaction rights (usually associated with spending) before the grantor can recognise the expense, could exacerbate this problem.
  - For grant makers in USA, the current recognition of grant expenses is driven by whether not the grant recipient has an 'equivalency determination' that deems it to be an NPO according to USA criteria. If the grantee is deemed 'charitable', grant expenses can be recognised by the grantor on obligation to disburse. If not, recognition of expenditure by the grant maker can only be made as the grantee itself spends the funds. This may have implications for the definition of grant recipient in Para 2.3.
  - These practical issues ought to be discussed with the Donor Reference Group.

1.3 Grant expenses – Disclosures

Discussion summary

- Comments from PAG members (Q5)
  - One member affirmed the value of the proposed disclosures, stressing the importance of such disclosures being limited to material matters only.
  - Disclosures need to link closely to the narrative report. Users are most interested to know what difference the funder is seeking to make in providing these grants. This resulted in the UK SORP requiring NPOs to provide information about recipients of institutional grants.
  - Disclosures should be kept simple, avoiding duplication and disaggregation of data.
  - Re Para 4.2, classification of grant expenses according to the headings that are yet to be determined in INPAG ED Part 3. If a functional expenditure classification approach is taken, where expenses are classified according to the types of activities or outcomes they are advancing, it will also be important to show that these costs are grants by nature, so that it is possible to assess the proportion of an NPO's costs that relate to grant making vs direct implementation of activities.

2.1 Revenue

Discussion summary – Q1

- There was a preference for INPAG to cover all types of revenue a single section, rather than split between separate sections for ‘exchange’ and ‘non-exchange’ revenue. This makes it easier for users if there are exchange and non-exchange aspects to a single transaction.
- Having a separate section on gifts-in-kind might be useful, due to the specific and complex measurement issues. Sections for cash transfers vs in-kind revenue could be more helpful than separate sections on exchange / non-exchange revenue.
- One member suggested a single section would be preferable, for instances where cash and in-kind elements are part of the same transaction. Another mentioned that separate sections make it easier to navigate and apply.
- The terms ‘exchange’ and ‘non-exchange’ are not familiar in the sector globally, even to some PAG members. A distinction between ‘self-generated revenue’ (or equivalent term) and ‘grants and donations’ would feel more aligned to the way the sector thinks about and talks about revenue. Self-generated revenue may have tax implications, whereas grants and donations generally do not.
- The distinction between a restriction and a condition is not apparent in the definition of a compliance obligation in Para 4.8. This is such an important fork in the decision tree for revenue accounting treatment that the it needs to be clearer to users.

2.2 Revenue

Discussion summary – Q4

- The term ‘binding arrangement’ raises similar issues to the discussion of grant expenditure – a constructive obligation based on a reasonable expectation of probable receipt might be better.

2.3 Revenue - Gifts-in-kind

Discussion summary

- A number of points were made about measurement of gifts-in-kind, which will be relevant to future discussions, but were not directly related to the issues in this PAG paper, and are not recorded here.