INTERNATIONAL FINANCIAL REPORTING
FOR NON PROFIT ORGANISATIONS

Technical Advisory Group Issue Paper

AGENDA ITEM: TAGED08-10
29 & 30 September 2022 – Hybrid

Grant expenses

Summary	This paper summarises respondents' feedback to the non-exchange revenue section of the Consultation Paper.
Purpose/Objective of the paper	To allow TAG members to consider the responses to Issue 4 of Part 2 of the Consultation Paper and the way forward.
Other supporting items	None
Prepared by	Paul Mason
Actions for this meeting	Comment on the proposed way forward.

CIPFA The Chartered Institute of Public Finance & Accountancy

humentum

Technical Advisory Group

Grant expenses

1. Consultation Paper Proposal

1.1 The recognition and measurement of grant expenses has been identified as a specific issue for non-profit organisations.

1.2 This paper covers the recognition and measurement of grant expenses. The paper summarises the feedback to the Consultation Paper, which identified a number of financial reporting challenges:

- Grant expenses are not currently explicitly covered in international accounting standards. With no specific guidance on grant expense transactions to assist NPOs with recognition and measurement, the accounting treatment of grant expenses can be a significant issue for NPOs.
- Difficulties arise because it is not always clear what has been promised to a grant recipient and what commitments have been created.
  - Grants can be awarded over multiple financial reporting periods, leading to questions of whether the whole amount should be recognised as an expense immediately or not recognised until the reporting period for which the grant is intended.
  - Measurement issues may also arise when the time value of money is significant.
- Significant judgement may be required to determine when a grant expense should be recognised. Grantors may impose conditions on the grant recipient which impact when a grant is recognised. Grant conditions are not always as clear as they could be. Some conditions may be more significant than others, which can impact the assessment of when they have been met.
- When the grant is paid before conditions are met, particular issues can occur. There might be two different circumstances:
  - Conditions relate to how the grant is spent – in these cases the grantor may need to assess whether the conditions are met (which might take place in stages) or are likely to be met.

  - 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.

- A separate transaction may need to be recognised where there is an obligation to return an asset. When a grant agreement includes return conditions, the awarding entity may need to consider if it has an asset prior to the grant recipient satisfying its obligations under the grant agreement.
- Identifying an obligating event between parties in order to recognise a grant expense may be challenging. This need exists whether the relationship from grantor to recipient is direct (ie from grantor to recipient) or indirect (ie from grantor NPO, to an intermediate NPO to the recipient). Any 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.
- Depending on the timing of the transfer/cash payment, an NPO may need to recognise an accrual or a provision in its accounts. Where the grant recipient has met the grant conditions or when the grant has no conditions, an NPO will need to accrue these amounts.

Alternative financial reporting treatments

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

1.4 Alternative 1, based on the international framework used as the basis for INPAG with additional guidance to assist NPOs with NPO-specific issues. This would include recommended additional disclosures.

1.5 Alternative 2, which builds on alternative 1 but requires that the principles being proposed in IPSAS ED 72 *Transfer Expenses* are incorporated. Incorporating these principles would provide additional guidance on grants with performance obligations and multi-year arrangements.

2. Consultation Paper Responses

Overall approach

2.1 An analysis of the responses to Issue 4 can be found in the Appendix to this issues paper.

2.2 Of those who responded to the issue, the vast majority (88%) agreed with the description of Issue 4, grant expenses. Only 6% disagreed. Respondents identified a number of issues which will need to be considered in developing the grant expenses section of INPAG:

- Some respondents noted that this topic was not one that caused issues in their jurisdictions. This is partly explained by the fact that in some of the respondents' jurisdictions, grant expenses are recognised when the grants are paid.
- Some grants may be given in kind (goods, services, etc.); this was not addressed in the Consultation Paper.
- Consistency with the revenue accounting was seen by some respondents as important. The INPAG secretariat note that this may not be possible if exceptions to the recognition and measurement principles for revenue are adopted for some services and gifts in-kind.
- Grant arrangements should be distinguished from procurement arrangements. The respondent noted that this is becoming more difficult, highlighting the example of social benefit bonds (where investors provide funding to NPOs, who then provide services – usually to governments – for which they are remunerated based on outcomes, with the return to investors being based on the level of remuneration).

2.3 Of those who responded to the issue, the vast majority (90%) agreed that the list of alternative treatments was exhaustive. However, respondents (primarily those who disagreed that the list was exhaustive) identified a number of areas which they considered were not adequately covered in the alternatives:

- One respondent questioned why there was no option that was fully consistent with IPSAS. The INPAG secretariat note that at this time, no IPSAS deals with grant expenses. While the IPSASB is developing a standard on non-exchange expenses, this has yet to be finalised, and it is likely that the proposals in ED 72, *Non-Exchange Expenses* will be modified in a final IPSAS.
- Non-performance related conditions were seen as significant. Time conditions, especially as they relate to multi-year grants were seen as particularly important. One respondent was of the view that clearly specified time-related conditions would normally prevent a grant recipient from recognising grant income relating to future reporting periods. However, they did not consider that the existence of a time-related condition alone is sufficient to prevent the donor from recognising a related grant expense and liability. The respondent noted that as a result, symmetrical accounting

between the donor and the recipient would be inappropriate. This contrasts with the view about symmetrical reporting noted earlier in this paper.

- Some respondents did not consider that the Consultation Paper provided sufficient detail on when a donor would have an obligation to make payment to a recipient, and should therefore recognise an expense. One respondent noted that this could be a particular issue in jurisdictions where grant arrangements included 'termination for convenience' clauses that allowed the donor to terminate the agreement at any time without the need for there to have been a breach of the agreement.

2.4 Of those who responded to the issue, the vast majority (90%) agreed with the advantages and disadvantages provided in the Consultation Paper. Some respondents considered that the Consultation Paper did not provide sufficient detail on a donor's obligations (see discussion in the previous paragraph, where this was also raised).

Alternative Financial Reporting Treatments

2.5 The Consultation Paper proposed two alternative financial reporting treatments, as explained above. Of those who responded to the issue, one third supported Alternative 1 and just under two thirds supported Alternative 2 (with one respondent having no preference).

2.6 The main reason provided for supporting Alternative 1 was concern with the approach taken in the IPSASB's ED 72. These respondents considered the ED 72 proposals over-complex and difficult for NPOs to put into practice, with the need to monitor the recipient's performance a particular concern. Consequently, they did not consider the approach in ED 72 would pass the cost-benefit test.

2.7 Those who supported Alternative 2 considered that the proposals in ED 72 would provide better, clearer guidance on key issues such as performance obligations and multi-year grants. These respondents considered the proposals in ED 72 to be appropriate for NPOs, and commented that they would improve comparability between NPOs. Some respondents also considered the approach would help distinguish between obligations and commitments, which would provide useful information for users of the financial statements. One respondent acknowledged the fact that greater information sharing would be required, but considered this would improve financial management.

2.8 One respondent did not support either alternative. In their view, once an NPO had paid the grant, they did not control any asset and should recognise an expense in full. They therefore disagreed with the additional guidance proposed for Alternative 1 and the proposals in ED 72 that would be incorporated into Alternative 2.

2.9 Respondents raised a number of issues to be addressed in developing the grant expenses section of INPAG, regardless of which alternative is adopted. These have already been discussed earlier in this paper (for example, time constraints, multi-year grants and non-performance conditions).

2.10 In addition to the recognition and measurement requirements, disclosure requirements will need to be developed

3. Way forward

3.1 As noted above, grant expenses are not currently explicitly covered in international accounting standards.

3.2 The IPSASB Is currently developing a new IPSAS, *Transfer Expenses*, based on its earlier consultation in ED 72, *Transfer Expenses*. These proposals formed the basis of Alternative 2, which received most support from respondents to the Consultation Paper. The IPSASB's latest draft of this standard was presented to the IPSASB at its September 2022 meeting and can be found here.

3.3 As the new IPSAS will be the only international standard covering grant expenses, and as the principles adopted in the new standard are expected to be consistent with those in Section 2 of INPAG, the INPAG secretariat is minded to base the grant expenses requirements in INPAG on this new IPSAS. It is expected that some modifications to reflect NPO's circumstances will be required. Some simplification of the wording is also likely to be required to ensure the text fits the overall style of INPAG.

3.4 The standard being developed considers matter that are relevant to NPOs such as:

- Funder/contractual arrangements[1];
- Situations where there is no binding arrangement;
- Identification of rights, assets and liabilities;
- Capital transfers; and
- Multi-year grants.

[1] A binding arrangement is an arrangement that confers both rights and obligations, enforceable through legal or equivalent means, on the parties to the arrangement. A contract is a type of binding arrangement.

3.5 IPSASB is expected to release a second exposure draft on *Transfer Expenses* at the beginning of 2023. In the meantime development will be based on draft versions presented to the IPSASB Board.

Question 1: Do TAG members agree with the proposal that the draft standard on transfer expenses being developed by IPSASB is used as the basis of grant expenses in INPAG?

September 2022

INTERNATIONAL FINANCIAL REPORTING
FOR NON PROFIT ORGANISATIONS

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%

CIPFA The Chartered Institute of Public Finance & Accountancy

humentum

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%