Technical Advisory Group
Issue Paper

AGENDA ITEM: TAGED08-07
29 and 30 September 2022 – Hybrid

Foreign exchange presentation (ED2)

Summary	This paper considers respondents' feedback to the prioritisation of issues section of the Consultation Paper, insofar as it relates to foreign exchange.
Purpose/Objective of the paper	To allow TAG members to consider relevant matters raised in the Identification and Selection of NPO-specific financial reporting issues section of Part 2 of the Consultation Paper and the way forward.
Other supporting items	None
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Actions for this meeting	Comment on the way forward.

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Foreign exchange presentation (ED2)

1. Introduction

1.1 The project team compiled a list of NPO-specific issues from academic studies, matters raised by standard setters and by stakeholders and members of the NPO community, including donors that was included in the Consultation Paper.

1.2 The criteria for prioritisation of accounting issues for the Guidance was set out in the Consultation Paper Part 2, Figure 2.2, namely prevalence, consequence, demand and feasibility.

1.3 'Foreign currency transactions' was included within the long list of NPO-specific financial reporting issues in the Consultation Paper Part 2, Table 2.2, item 22, but on initial assessment against the criteria, was not prioritised for consideration for the first phase of the Guidance.

1.4 One of the questions in the Consultation Paper was SMC 0c): Do you agree with the topics prioritised for the Guidance? If not, outline which topics should be added or removed and why?

1.5 Some respondents indicated that foreign currency transactions should be prioritised, while others considered that it should be removed from the long list. It was frequently raised in outreach on the consultation Paper as a significant issue.

1.6 After discussion at the PAG and TAG, it was agreed to add foreign currency transactions to the short list for Phase 1. In those discussions the view at the time was that foreign currency transactions are not an accounting recognition and measurement issue, but the possibility of wider issues were acknowledged.

2. Is 'Foreign Currency Transactions' an NPO specific issue?

2.1 Existing international standards contain guidance for the treatment of income and expenditure in foreign currencies, and the disclosure of accounting policies about how an entity choses which exchange rate to use. They also include guidance on the translation of assets and liabilities held in foreign currency and the treatment of realised and unrealised gains arising.

2.2 It can therefore be argued that guidance that would be relevant for NPOs' general purpose financial reports (GPFRs) already exists, and there may not be additional considerations that would warrant inclusion in the Guidance being produced by the IFR4NPO Project.

2.3 Conversely, it can also be argued that there are some differences in the NPO sector that mean that sector specific guidance would be beneficial. Some of these are discussed below.

Foreign currency rate assumptions in donor budgets

2.4 Foreign currency rate assumptions in donor budgets may subsequently become part of the contractual or quasi-contractual funding terms to an NPO. If an NPO is required, under such obligations, to cover any spending deficits arising because of reductions in the value (due to changes in the exchange rate) of the donor funding this has a real impact on the NPO's reserves. Therefore, such "quasi-contractual" obligations to donors can create liabilities for NPOs which are not easily visible in their accounting for the impact of foreign exchange movements. It is important that such effects should be transparent to both donors and to the NPOs themselves.

Donor specified exchange rates in project reporting

2.5 Sometimes donors specify the periodic exchange rates which must be used in project reports to translate the expenditure they fund. In such instances, where the donor-specified rate is different from the rate achieved and used in financial reporting, there will be differences between the project reporting information and related information in the financial statements. Again, it is important that NPO accounts are transparent about this and enable such impacts to be quantified, especially as they relate to restricted or unrestricted funds.

2.6 Some NPOs may currently be preparing financial statements using donor specified rates to facilitate reconciliation with project reports, so may face additional issues when moving to an INPAG compliant treatment.

Limitations in managing foreign exchange risk

2.7 Donors sometimes prohibit NPOs from using hedging mechanisms to manage their exchange rate risks, but many NPOs lack unrestricted reserves to cover any losses arising. Transparency over this issue would support advocacy efforts to improve the quality of funding and fairness of associated requirements.

Other issues related to foreign exchange risk

2.8 Where NPOs receive funding in arrears in relation to expenditure in a foreign currency, and they pre-finance this foreign currency expenditure from their own reserves, this could have a real impact on their base currency reserves when they are replenished, given that exchange rates will normally have moved between the pre-financing date and the donor payment date. Such differences represent a real financial uncertainty to the NPO.

3. Is 'Foreign Currency Transactions' an issue for general purpose financial reports?

3.1 It can be argued that donor-imposed exchange rates are only relevant for special purpose reports, and not for general purpose financial reports.

3.2 As INPAG mandates separate reporting and disclosure in relation to the aggregates of funds with restrictions and funds without restrictions in Section 2, NPOs will need to separate foreign currency realised and unrealised gains and losses between those funds. For some NPOs they could also usefully report on the extent to which each individual fund/programme is affected by realised and unrealised foreign exchange gains and losses, bearing in mind that often the equivalent cash assets in each currency held are combined into single bank accounts.

3.3 NPOs may report their expenditure by function – for example programme/direct costs, fundraising costs and administration costs. Often such reporting requires the use of a reasonable and justifiable cost allocation methodology. For NPOs, such a methodology could transparently include their approach to allocating foreign exchange gains and losses, and this could be explained in its accounts. Conversely, classifying foreign exchange gains and losses separately from programme/direct expenditure and other expenditure categories can reduce transparency over the real extent of resources deployed to the major functions of the NPO.

4. Way forward

4.1 The Secretariat view remains that in relation to recognition and measurement, technically there is no need for additional guidance, and as a consequence no significant changes will be necessary for INPAG Section 30 *Foreign currency translation*.

4.2 The issues highlighted above could be considered more in the nature of special purpose financial reporting. However, for certain categories of NPO the reporting issues are commonplace or perhaps even pervasive. It is therefore proposed that in taking forward this topic that the presentational and disclosure issues related to foreign currency transactions are the focus.

4.3 Addressing foreign exchange impacts in NPO GPFRs may also present an opportunity for improving consistency and reconcilability between donor reports and GPFR that could have a significant impact on accountability, transparency and reducing multiple audits. Addressing these issues may also have a beneficial effect on the usability and uptake of INPAG.

4.4 Having regard to the priority attached to these issues in responses to the consultation, and the nature of likely presentation issues it is proposed that this topic be progressed during the development of ED 2.

4.5 It is not proposed to create a separate Section for the presentation issues associated with foreign currency transactions. Instead it is proposed that these will be addressed through the topics relating to revenue and expenses that will be developed in ED2 and ED3. It is proposed that the overarching principles are captured in Section 30.

Question 1: Do TAG members agree that guidance on foreign exchange presentation should be progressed during the development of ED 2?

Question 2: Do TAG members agree with the approach of embedding disclosure requirements in the relevant revenue and expense sections, with the overriding principles in Section 30?

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