INTERNATIONAL FINANCIAL REPORTING
FOR NON PROFIT ORGANISATIONS

Donor Reference Group

Donors' use of cash vs accrual based information: DRG Meeting Report, January and April 2022

Background

The IFR4NPO project is developing Guidance to address the needs of readers of general-purpose financial reports of non-profit organisations (NPOs). In the project Consultation Paper issued on 28 January, 2021, Part 1 Chapter 3 examined the advantages and disadvantages of cash, modified and accrual based Guidance. The Paper concluded 'Examining cash, accrual and modified cash accounting against the objectives of the Guidance, it is clear that for most entities, accrual has the greatest advantages and the least significant disadvantages.'

However, despite the advantages of accrual-based Guidance, many donors may require reports of grant utilisation to be submitted on a cash basis. The January and April 2022 meetings of the Donor Reference Group sought to understand whether and why donors require cash basis or modified basis reports, and to explore appetite for accrual basis information and harmonization.

In their meeting May meeting, the Technical Advisory Group agreed that the drafting of a format for a supplementary, optional Donor Statement, within the general-purpose financial statements, would be led by Humentum with particular input from the Donor Reference Group.

Do donors always require reports on a cash basis?

The assertion, often stated by NPOs, that donors require reports on a cash basis was not strongly upheld by DRG members. Comments included:

- Our agreements are not necessarily explicit about accounting basis required for expenditure reports.
- The focus is on reporting against the budget, and the accounting basis might not be clear either way
- There could be an implicit assumption about the basis, for example if the budget includes capital items, or the format show movement in cash balances

- Our staff are trained to read reports prepared on a cash, modified and accrual basis
- USAID drew attention to ADS Chapter 591, Section 5.1 which refers to a 'Schedule of Expenditures of USAID awards' within the general purpose financial statements prepared in accordance with US GAAP or international accounting standards (which are all accrual-basis). Reference to 'Fund Accountability Statement' was removed in June 2021.
- The cycle of payments advances from donors, spending and liquidation by grantees and requesting the next tranche of funds is necessarily cash focused.

What types of special purpose financial reports to donors require?
Analysis of member comments, revealed references to two distinct types or purposes of reports, although these may also be merged in practice.

- End-of-year, end-of-project or interim expenditure reports where the key focus is **accountability for funds** and associated achievement of project goals. These are more likely to be subject to formal audit processes.
- Interim reports of funds utilization and forecasts, where the key focus is **pragmatic cash flow** – ensuring grantees have enough, but not too much cash for programme needs. These may be subject to different levels of checks, depending on risk, often with a focus on detecting potential misuse.

The second type necessarily focus on cash utilization, balances and needs. There is more potential for flexibility about accounting basis in the first type.

When donors require reports on a cash basis, or with a focus on cash balances, what are the reasons for that?
Members mentioned four core reasons:

- **Restricted funding:** Funders that gave unrestricted funding, noted that the need for cash basis reporting is linked primarily with the practice of restricted grant making.
- **Pragmatic:** releasing cash to the grantee – the payment request is a cash request, and approval is often dependent on showing that the previous tranche has been spent.
- **Compliance:** The IRS in USA require charitable expenditure to be reported on a cash basis. The Treasury department in UK requires that funds are given as needed rather than 'in advance of need'.
- **Grantee capacity:** Some grantees lack the staffing or system capacity for more complex accruals-based accounting. DRG members noted that, where there is a benefit to the NPO in building this capacity, that ought to be a focus for funders.

Does the level of flexibility about basis vary according to the type of cost?

Due to the implicit rather than explicit nature of the requirements of most funders, this question was not easy to answer. Comments included

- Where a grant includes funds for **capital expenditure**, donors are interested to see that the asset has been purchased (cash basis), rather than how it is depreciated over time (accrual basis)
- Where a grant includes contribution to overheads or **indirect costs**, there is interest in seeing that annual or lumpy costs (such as insurance, rent or audits) are spread out over the relevant periods to avoid unfair allocation of such costs to particular periods or grants
- For **other types of costs**, such as payroll, programme expenses paid in advance or in arrears, and items purchased for distribution, there was little consensus, but examples were mentioned where grantees requests for specific treatments were considered and accepted where reasonable.
- In terms of grant periods, there are often **strict eligibility rules about timing**. Costs should be incurred within the grant period. For example, a cash payment within the period relating to costs for later periods would not be eligible. Some grantees mentioned that they allow a few months for grantees to finish making payments for goods and services used during the grant period but paid later.

Is accounting on both cash AND accrual basis inevitable?

Members noted that even in their own institutions, and for many of their larger national NGO grantees, they keep books and generate reports on an accrual basis for reliable financial information and to comply with accounting standards. But they also have to prepare reports for tax purposes and for their own donors on a cash basis.

This requires technical skill in reconciliations, and sophistication in accounting systems so that reports can be run with or without accrual basis adjustments. In some cases, the solution is keeping multiple sets of books for the different purposes. Members questioned whether attempting to address this challenge through a harmonization approach was even theoretically possible, and perhaps capacity building for NPOs is the only approach.

While acknowledging the considerable challenge, the project is seeking to find solutions that can be practical for a large number of smaller NGOs around the world that lack the required technical expertise and sophisticated accounting systems.

Members expressed an interest to see drafts of possible formats and examples as early as possible.

Conclusion

Members of the DRG made clear that there are a number of different practices regarding cash vs accrual-based reporting, and for a variety of reasons. Many expressed an interest to learn from one another, develop consistent approaches and support harmonization for the sake of their grantees, and the professionalisation of non-profit accounting globally.