Practitioner Advisory Group Issue Paper

AGENDA ITEM: PAGED09-03

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Foreign Currency Translation

Summary	This paper summarises the proposals for the INPAG foreign currency translation guidance for initial discussions with PAG and TAG.
Purpose/Objective of the paper	To allow PAG members to consider any practical issues associated with these proposals.
Other supporting items	None
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Actions for this meeting	Advise on: • Proposed application of exchange rate changes to restricted fund • Additional disclosures of exchange rate impacts on restricted funds • Application guidance for use of presentation currency for donor reporting

Practitioner Advisory Group

Foreign Currency Translation

1. Background

1.1. A number of respondents to the Consultation Paper issued in January 2021 provided feedback that foreign currency translation should be treated as a priority topic for inclusion in INPAG. This feedback was discussed with both the PAG and the TAG. The PAG strongly supported the inclusion of this topic in INPAG, given the significant practical difficulties experienced by NPOs.

1.2. The TAG in its consideration of this feedback sought to understand the nature of the concerns raised in feedback from respondents. Through these discussions the conclusion was that the issues being raised were not about the accounting principles for foreign currency translation, but the application of those principles in the NPO context and particularly the presentation and disclosure of foreign currency gains and losses associated with grant funding.

1.3. As a consequence, it was decided to prioritise this topic for inclusion in INPAG. At the September TAG meeting it was agreed that in the approach to this topic the focus should be on presentation and disclosure and associated application guidance and implementation guidance. It was agreed not to review the principles for accounting for foreign currency translation in the *IFRS for SMEs* Accounting Standard.

1.4. As a result, proposed changes to core guidance are very limited. The current focus of INPAG guidance is on implementation guidance, which addresses potential impacts of foreign exchange gains and losses on grant funding. Given the potentially wide application of foreign currency translation within NPOs, both the scope of examples included, and their applicability should be considered.

2. Changes to core guidance

2.1. Core guidance has been left unchanged except for:

- Changes to reflect NPO terminology
- The inclusion of an additional requirement to disclose foreign exchange gains or losses arising in relation to restricted funds separately from other foreign exchange gains or losses. The purpose of this requirement is to provide users of the financial statements with greater transparency over the impact of changes in

exchange rates on restricted fund agreements with donors.

Question 1:	PAG members are asked for their views on whether providing separate disclosure of foreign exchange gains or losses arising in relation to restricted funds would be helpful in providing greater transparency over the impact of exchange rate movements on restricted funds.

3. Implementation guidance

3.1. Implementation guidance with illustrative examples has been developed for foreign currency translation. A number of examples have been created using scenarios where grant funds that have been made in currencies other than the functional currency. This is an issue we understand to be of significant concern to NPOs. The illustrative examples show how income, expenses and gains and losses will be shown on the face of the Income and Expenses Statement, including whether they will be shown as 'with restrictions' or 'without restrictions'. The examples also show the impact on unrestricted funds in the balance sheet, which has been stated as important in understanding the sustainability of NPO finances.

3.2. The examples developed address scenarios where grants are received in advance and in arrears. In each scenario, the impact of strengthening and weakening of exchange rates and different bases of measuring grant expenditure are included. Three of these examples have been included in Annex A.

3.3. Example 1 sets out a scenario where grant funding is provided in advance in a foreign currency. Expenditure incurred by the NPO in its own functional currency are measured against the grant using the exchange rate when the expenditure is incurred. As can be seen in the example, if exchange rates change between when the NPO receives the grant and when the NPO incurs the grant expenditure, this will result in an exchange rate gain or loss. The example proposes that the NPO would:

- account for the loss arising from the change in exchange rates as an unrestricted item, with a corresponding increase in the liability for the obligation to incur grant related expenses
- record restricted income as the amount initially received at the spot rate on receipt, since this represents the amount received
- record the increase in income, arising from the increase in liability, as unrestricted income

- record all grant related expenditure as restricted, including the additional expenditure required because of the change in exchange rates
- the resulting deficit of restricted expenditure over restricted income is funded by a transfer from unrestricted funds

Question 2:	PAG members are asked for their comments on this example, including the ease of application of the approach suggested and the helpfulness of the example to preparers?

3.4. Example 2 is a similar scenario to example 1, except that the grant expenditure is measured at a rate defined in the grant agreement. This results in an immediate difference between the income received and the obligation to incur expenditure. This difference is recorded in other gains or losses, since it doesn't arise from a change in exchange rates but from the terms of the grant agreement. Other than this difference, example 2 has a similar outcome to example 1.

Question 3:	PAG members are asked for their comments on this example. Is the use of predetermined rates sufficiently common to merit an example?

3.5. Example 3 considers the scenario where grant funding is provided in arrears in a foreign currency to reimburse expenditure incurred by the NPO in its own functional currency, the expenditure being measured against the grant using the exchange rate when the expenditure is incurred. If exchange rates change between when the NPO incurs the grant expenditure and when it receives reimbursement, it will result in an exchange rate gain or loss on the NPO's grant receivable. The example proposes that the NPO would record this exchange rate gain or loss in unrestricted income.

Question 4:	PAG members are asked for their comments on this example. Is it considered helpful to include example 3 or is sufficient guidance provided by the previous examples?

Annex A

Example 1 – Grant funded in advance with expenses measured at rate when incurred

On 1 January 20X3, NPO X receives a grant of CY50 from donor Y, when the exchange rate is 2CX = 1CY. The functional currency of X is CX. The grant agreement specifies that the grant related expenditure is measured against the grant at the spot rate when the expenditure is incurred.

Assuming NPO X converts the grant into CX100 on receipt, at the spot rate, and only incurs expenditure in currency CX, NPO X accounts for this example as follows:

Recognition of grant receipt as a binding grant arrangement obligation (BGA obligation)

Dr Cash	CX100	
Cr BGA obligation		CX100

Recognition of grant related expenditure and related grant revenue
Since the binding grant arrangement obligation is an obligation to incur grant related expenses, which is denominated in CY and measured against CX only when the expense is incurred, the binding grant arrangement obligation is remeasured at the reporting date using the spot exchange rate of 2.5CX = 1CY when the expense is incurred

Dr Foreign exchange loss	CX25	
Cr BGA obligation		CX25

NPO X incurs grant related expenditure of CX100 on 1 June 20X3, when the spot rate is 2.5CX = 1CY.

Dr Expenses - restricted	CX100	
Cr Cash		CX100
Dr BGA obligation	CX100	
Cr Revenue – restricted		CX100

Clearing additional grant obligation arising due to change in exchange rate
NPO X has an obligation to spend a further CX25, being the remaining balance of the binding grant arrangement obligation. As a result, NPO X incurs a further CX25 of expenditure at the same spot exchange rate.

Dr Expenses – restricted	CX25	
Cr Cash		CX25
Dr BGA obligation	CX25	
Cr Revenue – unrestricted		CX25

The additional revenue of CX25 is recognised as unrestricted as it exceeds the value of the grant received by NPO X, measured at the spot rate on the date of settlement.
From the perspective of donor Y, X has incurred grant related expenditure of CY50, being CX125 measured at the spot rate of 2.5CX = 1CY on the date the expenditure is incurred. The change in exchange rate results in NPO X incurring an exchange loss and incurring CX25 more expenditure than was received as revenue.

Movement between reserves
The transactions result in a deficit of CX25 in restricted income, which must be funded from unrestricted income.

Dr Funds without restrictions	CX25	
Cr Funds with restrictions		CX25

After recording all the transactions, the impact on X's primary statements is as follows:

	Restricted CX	**Unrestricted CX**	**Total CX**
Statement of income and expenses			
Revenue	100	25	100
Expenses	(125)	0	(100)
Operating surplus/(deficit)	(25)	25	0
Foreign exchange gain/(loss)	0	(25)	(25)
Surplus/(deficit)	0	(25)	(25)
Statement of changes in net assets			
Surplus/(deficit)	(25)	0	(25)
Movement between reserves	25	(25)	0
Closing balance	0	(25)	(25)
Statement of financial position			
Cash	0	(25)	(25)

If, in this scenario, the exchange rate on 1 June 20X3 had been 1.5CX = 1CY, then NPO X would have recorded an exchange gain of CX25 on revaluation of the binding grant arrangement obligation. As a result, NPO X may only have needed to incur expenses of CX75, resulting in a cash surplus of CX25. However, if the grant agreement had included a requirement that NPO X was required to spend any cash surpluses, then the binding grant arrangement obligation would have needed to be increased by CX25, offsetting any reduction because of exchange rates, since the obligation under the grant agreement is never less than CX100 in this instance. This increase in obligation is recorded as other gains or losses as it arises from a term in the grant, not as a direct result of foreign exchange translation.

Though NPO X would incur grant related expenses and receive grant revenue of CX100, from the perspective of donor Y, expenditure of CY67 would have been incurred, more than the original grant provided in CY. The additional expenditure arises from the requirement in the grant agreement for NPO X to spend any exchange gains on grant related expenditure. The resulting impact on NPO X's primary statements would be as follows:

	Restricted	**Unrestricted**	**Total**
	CX	**CX**	**CX**
Statement of income and expenses			
Revenue	100	0	100
Expenses	(100)	0	(100)
Operating surplus/(deficit)	0	0	0
Other gains/(losses)	0	(25)	(25)
Foreign exchange gain/(loss)	0	25	(25)
Surplus/(deficit)	0	(0)	(25)
Statement of changes in net assets			
Surplus/(deficit)	0	0	0
Movement between reserves	0	0	0
Closing balance	0	0	0
Statement of financial position			
Cash	0	0	0

Example 2 – Grant funded in advance with expenses measured at a predetermined rate

On 1 January 20X3, NPO X receives a grant of CY50 from donor Y, when the exchange rate is 2CX = 1CY. The functional currency of X is CX. The grant agreement specifies that grant related expenditure is measured using a defined rate of 3CX = 1CY

Assuming NPO X converts the grant into CX100 on receipt, at the spot rate, and only incurs expenditure in currency CX, NPO X accounts for this example as follows:

Recognition of grant receipt
Though NPO X receives CX100 in cash on 1 January 20X3, the agreement imposes an obligation to incur expenditure of CX150 (measured at the rate of 3CX = 1CY set out in the agreement). As a result, NPO X records an obligation of CX150. The increase of CX50 is recorded in other gains and losses as it arises in relation to a term in the grant agreement, not from a change in exchange rates.

Dr Cash	CX100	
Dr Other gains and losses	CX50	
Cr BGA obligation		CX150

Recognition of grant related expenditure and related grant revenue
NPO X incurs grant related expenditure of CX100 on 1 June 20X3, when the spot rate is 2.5CX = 1CY.

Dr Expenses - restricted	CX100	
Cr Cash		CX100
Dr BGA obligation	CX100	
Cr Revenue – restricted		CX100

Clearing additional grant obligation arising due to change in exchange rate
NPO X has an obligation to spend a further CX50, being the remaining balance of the obligation based on the exchange rate on receipt of the grant. As a result, NPO X incurs a further CX50 of expenditure at the same spot exchange rate.

Dr Expenses – restricted	CX50	
Cr Cash		CX50
Cr BGA obligation	CX50	
Cr Revenue – unrestricted		CX50

The additional revenue of CX50 is recognised as unrestricted as it exceeds the value of the grant received by NPO X, measured at the spot rate on the date of settlement
From the perspective of donor Y, NPO X has incurred grant related expenditure of CY50, being CX150 measured at the rate of 3.0CX = 1CY as defined in the agreement, whereas NPO X incurs CX50 more expenditure that was received as revenue.

Movement between reserves
The transactions result in a deficit of CX50 in restricted income, which must be funded from unrestricted income.

Dr Funds without restrictions	CX50	
Cr Funds with restrictions		CX50

After recording all the transactions, the impact on X's primary statements is as follows:

	Restricted CX	Unrestricted CX	Total CX
Statement of income and expenses			
Revenue	100	50	150
Expenses	(150)	0	(150)
Operating surplus/(deficit)	(50)	50	0
Other gains/(losses)	0	(50)	(50)
Surplus/(deficit)	(50)	(0)	(50)
Statement of changes in net assets			
Surplus/(deficit)	(50)	0	(50)
Movement between reserves	50	(50)	0
Closing balance	0	(50)	(50)
Statement of financial position			
Cash	0	(50)	(50)

Example 3 – Grant reimbursed expenses in arrears at rate when expenses incurred

On 1 September 20X2, NPO X enters into an agreement for a grant with donor Y, specifying expenditure will be reimbursed up to an amount of CY50. NPO X incurs grant related expenditure of CX100 on 1 January when the spot exchange rate is 2CX = 1CY. The grant agreement specifies that the grant related expenditure is measured against the grant at the spot rate when the expenditure is incurred.

Assuming donor Y reimburses the expenditure on 1 June 20X3, when the spot rate is 2.5CX = 1CY, which NPO X converts into CX immediately at the spot rate, then NPO X accounts for this example as follows:

Recognition of grant related expenses and related grant revenue

Cr Cash		CX100
Dr Expenses – restricted	CX100	
Dr Grant receivable	CX100	
Cr Revenue – restricted		CX100

Settlement of grant receivable

Since the grant related expenditure is measured by the donor at the rate when the expenditure is incurred, the donor agrees to pay CY50 to NPO X, being CX100 translated at the spot rate of 2CX = 1CY on 1 January 20X3. When the expenditure is due to be reimbursed, the spot rate is

2.5CX = 1CX, the receivable of CY50 is equivalent to CX125. NPO X recognises an exchange gain of CX25.

Dr Grant receivable	CX25	
Cr Foreign exchange gain		CX25

The settlement of the grant clears the receivable, after revaluation.

Dr Cash	CX125	
Cr Grant receivable		CX125

After recording all the transactions, the impact on X's primary statements is as follows:

	Restricted CX	**Unrestricted CX**	**Total CX**
Statement of income and expenses			
Revenue	100		100
Expenses	(100)		(100)
Operating surplus/(deficit)	0		0
Foreign exchange gain/(loss)	0	25	25
Surplus/(deficit)	0	25	25
Statement of changes in net assets			
Surplus/(deficit)	0	25	25
Movement between reserves	0		0
Closing balance	0	25	25
Statement of financial position			
Cash	0	25	25