

IFR4NPO Project

Discussion Summary and Requests Practitioner Advisory Group meeting

7 June 2023
PAGED10



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

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, any small group discussions are not captured.
- 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

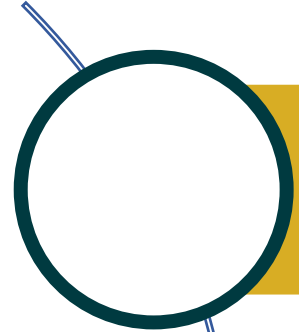
The meeting was held online, chaired by Tim Boyes-Watson, and attended IFR4NPO Project team members Samantha Musoke, Karen Sanderson, Paul Mason and Phill Trotter in addition to the following PAG members:

Dorothea Malloy, Genny Kiff, Karina Vartanova, Nigel Davies, Pablo San Martin, Paul Winrow, Philip McMinn Mitchell, Tejas Merg Desai & Tshewang Penjor.

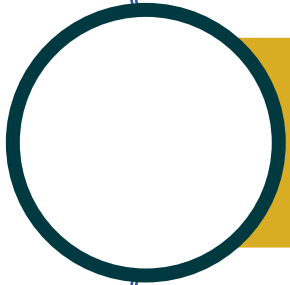
Apologies were received from Hikmet Abdullah, Caroline Cordery, David Gilchrist, & Kenneth Makanga.



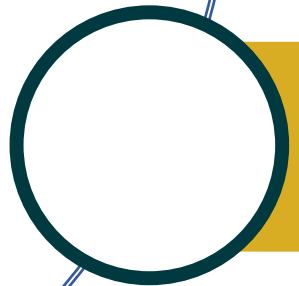
Session outline



1. Update



2. Revenue



3. Classification of expenses

1 Update

Discussion summary

- Work on INPAG Exposure Draft 2 is progressing. It will cover revenue, grant expenses, foreign exchange and inventory. Plan to finalise the text in late July and publish in late September.
- A number of issues have arisen during recent focus groups. For more complex issues that we might not be able to fully resolve in the timeframe, we will draft 'Specific Matters for Comment' to seek a broad range of feedback before finalising.
- The topic of revenue has presented some complexities, particularly unwinding issues relating to recognition, measurement, and presentation. ED3 will likely contain a new section called 'fund accounting' to address some of the presentation issues that contribute to the complexity of understanding revenue accounting. ED2 will focus on recognition and measurement.
- Work on ED3 is also progressing, including 'classification of expenses' under discussion today. It will also include Supplementary Statements, fundraising costs and all the other sections of the *IFRS for SME Accounting Standard* that will be adapted for inclusion in INPAG.

2.1 Grants and donations

Discussion summary

Enforceability

- Enforceable rights are key to the conceptual basis outlined in INPAG, without them there is no basis for deferring revenue recognition once funds are received. There were variable experiences as to whether rights were actually enforced in practice.
- **Rare in practice** - while agreements may include references to jurisdiction, arbitration, or court proceedings, the practical enforcement of these terms is rare in the NPO sector. In some jurisdictions, rule of law is not presumed, and funding arrangements are based more on trust and risk.
- **Power dynamics** - Donors can terminate or withdraw from previously signed grant arrangements. Pragmatically, much enforcement is through the imbalance of funders' power versus the NGO.
- **Enforced** - Some donors (eg USAID) have disputes and appeals provisions within their agreements. In India, there have been instances of agreements being enforced through arbitration or out of court settlements.

2.1 Grants and donations

Discussion summary

Members distinguished between various types of requirements within a grant agreement that could be enforceable:

- **Non-Performance:** Non-delivery of goods or services (eg 10,000 vaccinations) / non-achievement of intended social good outputs (eg 100 midwives trained) / not applying best efforts to carry out agreed activities.
- **Illegal or sanctioned activities:** Such as fraud, sexual exploitation, terrorist financing, drug trafficking etc
- **Non-Compliance:** Failure to comply with process requirements (such as obtaining 3 quotes), or other eligibility criteria (eg flying business class / buying alcohol).
- **Failure to meet administrative requirements:** Such as submitting expenditure and activity reports, undergoing audits / evaluations etc

A member questioned whether all of the above types of requirements within a grant agreement would necessarily give rise to a 'compliance obligation' as defined in the issue paper. It was commented that absence of performance-based requirements would present practical difficulties in applying the 5-step revenue recognition model.

2.1 Grants and donations

Discussion summary

Grants vs contracts

- The use of terminology borrowed from contract law may not be appropriate for NPO grant arrangements, which are structured donations rather than commercial contracts. They lack the commercial substance and remedies associated with contract law (such as damages, consequential losses, consumer rights etc).
- One member proposed using the language of 'undertakings'. Instead of treating grant agreements as contracts aimed at recovering funds, it should be viewed as an open and transparent process of fund transfer, highlighting accountability and transparency.
- A grant arrangement could give rise to a present obligation if a grantee made performance-based undertakings and agreed to sanctions (such as withholding of payment) in the event of under-performance.

2.1 Grants and donations

Discussion summary

Grants vs contracts

- Other members noted that grant agreements do appear to be drafted in contractual terms. Not all legally framed agreements would meet the criteria of being 'binding grant agreements', depending on the purpose of the funds.
- Introductory comments relating to slide 3 implied that 'most' grant arrangements would fall into the category of 'non-binding', but in some members' experience and interpretation, most would in fact be 'binding', because failure to demonstrate compliance can result in withholding of reimbursement (for expenses incurred by the NPO) or requiring repayment of funds already remitted.
- ECHO remits grant funds in large tranches but their usage needs quantifiable accounting. Medair has to show the value of grant funds received and not yet earned in their accounts each year.

2.1 Grants and donations

Discussion summary

- The 5-step model proposed in INPAG is drawn from IPSAS (public sector) rather than IFRS 15 (commercial).
- The concept of a 'present obligation' in the conceptual framework is pivotal in ensuring a consistent approach to revenue recognition or deferral, even if practice around the world with respect to accounting for grants has been different.
- Funds may be received in advance without strict performance obligations, but with an understanding that it will pay for activities in future periods. Propose exploring a broader understanding of deferrals that goes beyond the strict fulfillment of performance obligations.

2.1 Grants and donations

Discussion summary

- Increasingly, Artificial Intelligence algorithms will be conducting analysis of financial statements, which could impact of credit worthiness of NPOs. Fluctuating surpluses and deficits may not be understood by these models.

Recommendation

- Clarify, during ED2 consultation, that presentational aspects of fund accounting, which provides an alternative means to communicate obligations that are not liabilities, will be proposed in ED3.

2.2 Donations in kind

Discussion summary

- The burden of challenges associated with assigning and justifying fair value may be disproportionate to the benefits for small and medium NPOs which INPAG is designed for.
- What about situations where there is no market (eg donations of COVID vaccines?), or the specification is higher than needed (eg a high class van is donated, but a cheaper one would have been adequate)?
- Donors such as USAID are particularly interested in the value of donated goods or services when they relate to an award, for example for match funding. In such cases USAID requires financial records and supporting documents, which would include specifying the appropriate fair value.

Recommendation

- Refer to the fair value hierarchy.

2.2 Donations-in-kind

Discussion summary

- The exception to delay measurement of low-value donated items until they are used or sold is pragmatic.
- In many jurisdictions, ie those without broad tax exemptions for NPOs, the recognition of donations in-kind could have tax implications.

2.3 Services in kind

Discussion summary

- Comparability is key, which is a strong case for recognition rather than just disclosure.
- 'Mission critical' could be defined as: the NPO would have to pay for the services if they were not given free, or at a subsidised rate. If a donation is enabling an organisation to do its job, then valuation shows the true cost of doing business.
- The proposed approach of not requiring disclosure for non-mission critical services is pragmatic, but may not apply to different business models. An NPO that has funding and would otherwise pay for services, is very different from a wholly voluntary organisation that would simply not exist otherwise.
- For many NGOs, services-in-kind demonstrate the NGO's credibility and goodwill in the community. In many cases the value is material e.g. shared software received from donors, discounted services from consultants/ vendors etc. Both mission criticality and materiality should be used as a criteria.

2.3 Services in kind

Discussion summary

- Depending on the NPO's model and users of its financial statements, the benefits of providing valuation information may outweigh the costs, and for others not so. If there were options within INPAG could allow NPOs to make that judgement for themselves.
- In UK charity trustees are not allowed to be paid, so finding fair value for their services would be difficult as there is no market. In such a case, disclosure seems meaningful while valuation less so.

3.1 Classification of expenses

Discussion summary

- Research presented by Scottish Charities Regulator and Charity Commission England & Wales, presented to the UK SORP committee in November 2021, suggests that members of the public, as donors, are interested to know about the difference that the money has made, ie a functional approach. They also have concerns about excessive salaries or administration costs . An argument was made for disclosures around staff costs (which is natural). So the public seems to want a hybrid approach.
- Donors each specify their expenditure categories. Harmonisation around this would be hugely beneficial for NPOs.
- Work on the Supplementary Statement is ongoing. There has generally been good reception from funders who see the value of having expenditure figures relating to their grant appearing in the general-purpose financial statements.

3.1 Classification of expenses

Discussion summary

- Need to consider cost/benefit. If costs are to be coded in many different ways (internal management information, special purpose donor reporting, external reporting by function, external reporting by type), this requires complex accounting systems. Lack of sophistication in accounting systems tends to drive NPOs to do one or the other
- One option is to keep functional reporting at very high level, eg charitable vs non-charitable, but this has created problems in UK.
- There needs to be a case for the utility of information to justify the cost of providing it. With respect to support costs, more donors are willing to 'pay what it takes' and cover an appropriate share of grantee support costs, but it is hard for NPOs to calculate and justify their rates without an audited base or standard methodology.