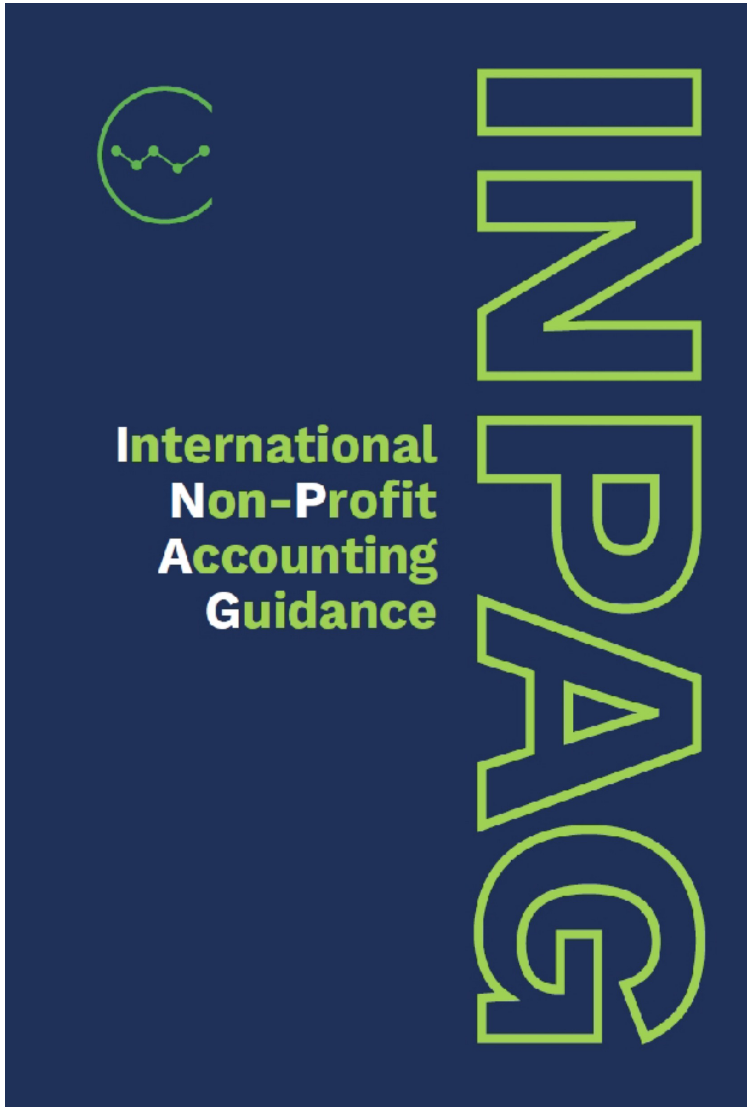
INTERNATIONAL FINANCIAL REPORTING
FOR NON PROFIT ORGANISATIONS




# Foreign Currency Translation:

# Impact on Restricted Income and Expenses

# FX translation – NPO related issues

Grants are often denominated in currencies other than the functional currency of the NPO recipient. Changes in exchange rates can result in the NPO incurring foreign currency exposure relating to the amount it is required to spend under the terms of the grant.

**These exposures can create financial challenges to NPOs -** especially those who do not have the means to enter into hedging arrangements.

**Different denominations can also create reporting challenges for NPOs -** grant donors frequently require a report setting out the expenditure incurred by the NPO, set out in the currency the grant is denominated in.

**The effect on results is impacted by whether the grant is paid in advance or in arrears, and how expenditure incurred by the NPO is measured in the currency of the grant -** exchange rate on date grant paid, expenditure incurred, or predetermined

# FX translation – NPO related issues

The following slides consider each of these issues, using 3 scenarios.

**Scenario 1**

Grant paid in advance.
NPO required to incur grant related expenditure increases due to changes in exchange rates

**Scenario 2**

Grant paid in advance.
NPO required to repay some of the grant as a result of changes in exchange rates

**Scenario 3**

Grant paid in arrears.
Impact of changes in exchange rates reduces grant receivable.

In all scenarios, the grant donor Y has functional currency CY and the NPO recipient X has functional currency CX. The grant is denominated in CY.

Grant related expenditure is measured against the grant at the spot rate when the expenses are incurred, as this is the scenario most likely to cause exchange rate exposures.

Where more than one accounting approach has been considered, alternative options are presented. Overall conclusions on the most appropriate option have been included.

Alternative methods for measuring grant expenditure, and for recording the impacts of changes in exchange rates on grant receipts are shown in the Appendices.

# Proposed way forward

There is a wide range of potential types of exchange rate exposures, depending on the terms of the grant. As a result, it is not practical to include guidance to cover all eventualities.

In addition, it has been decided not to review the principles for accounting for foreign currency in the *IFRS for SMEs* Accounting Standard.

As a result, it is proposed to include additional guidance in INPAG based on the following overall conclusions from the analysis in the following slides:

Liabilities for expenditure increases arising from changes in exchange rates, should be recorded as onerous contract provisions, charged to restricted expenses

Scenario 1 Option 2

Liabilities to refund grants received in advance arising from changes in exchange rates, should be recorded as monetary liabilities, charged to restricted income

Scenario 2 Option 2

All exchange gains or losses on grants paid in arrears should be recorded in unrestricted income, unless otherwise specified by the grant agreement

Scenario 3

Transfers between restricted and unrestricted reserves, resulting from the impact of exchange rates on surpluses or deficits in restricted funds, should be separately disclosed in the notes to the accounts

Scenarios 1 and 2 Option 2

Binding Grant Arrangement (BGA) obligations are non-monetary items

Scenarios 1 and 2 all Options

# Scenario 1 – Increase in expenditure due to change in rates

On 1 Jan 20X3, NPO X receives a grant of CY50 from donor Y. The grant requires X to spend all the grant on a specific project but there is no other measurable performance obligation. X expects to incur CX100 against the project, but it is possible to vary expenditure. The agreement expects that all funds donated will be spent on the project. The exchange rate at this date is 2CX = 1CY. The agreement specifies **grant related expenditure is measured against the grant at the spot rate when the expenses are incurred** . On 1 Jun 20X3, X incurs grant related expenditure of CX100 when the exchange rate is 2.5CX = 1CY

How should expenditure increase be reflected on the Statement of Financial Position?

- **Option 1** - Additional liability recognised as new BGA obligation (or an increase in the existing BGA obligation if the grant was not taken to income immediately).
- **Option 2** – Additional liability recognised as an onerous contract provision.

Where should the corresponding charge be recorded in the Statement of Income and Expenses?

- **Option 1** - If liability is recorded as new BGA obligation, then corresponding entry would be in other gains or losses, since it arises from grant gains or losses.
- **Option 2** -If liability is recorded as an onerous contract provision, corresponding entry would be in restricted expenses, since this is where the additional expenses would be recorded as they are incurred.

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# Scenario 1 – Increase in expenditure due to change in rates

## Option 1 – Additional liability as BGA

The obligation to incur an additional CX25 is recognised as a BGA obligation, charged to other gains and losses. When additional expenses are incurred, these are recognised as restricted, since they are incurred on the specific project. The BGA obligation is released to unrestricted income at this point, since it does not represent income received from the donor. The resulting deficit of CX25 in restricted reserves is transferred to unrestricted reserves, since the deficit must be funded from this unrestricted funds.

| Dr | Cr |
|---|---|
| ***Receipt recognised at 2CX=1CY*** | |
| Cash CX100 | Income -restricted CX100 |
| | |
| ***Grant expenses  at 2.5CX=1CY*** | |
| Expenses - restricted CX100 | Cash CX 100 |
| | |
| ***Recognition of obligation to incur futher expenditure*** | |
| Other gains/losses CX25 | BGA Obligation CX25 |
| | |
| ***Incurring additioanl expenditure to clear obliation*** | |
| BGA Obligaton CX25 | Income - unresticted CX25 |
| Expenses - restricted CX25 | Cash CX25 |
| ***Movement between reserves*** | |
| Funds without restrictions CX2 | Funds with restrictions CX25 |
| | |
| ***Grant recognised by donor Y at 2.5CX=1CY*** | |
| Grant expenses CY50 | Cash CY50 |

| | Restricted | Unrestricted | Total |
|---|---|---|---|
| **Statement of income and expenses** | | | |
| Income | 100 | 25 | 125 |
| Expenses | -125 | 0 | -125 |
| Operating surplus/(deficit) | -25 | 25 | 0 |
| Other gains/(losses) | 0 | -25 | -25 |
| Surplus/(deficit) | -25 | 0 | -25 |
| **Statement in changes in net asset** | | | |
| Surplus/(deficit)) | -25 | 0 | -25 |
| Movement between reserves | 25 | -25 | 0 |
| Closing balance | 0 | -25 | -25 |
| **Statement of financial position** | | | |
| Overdraft | 0 | -25 | -25 |

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# Scenario 1 – Increase in expenditure due to change in rates

## Option 2 – Additional liability as onerous contract provision

In this approach, the obligation is recognised as a provision for an onerous and hence charged to restricted expenses. The provision represents the additional project costs to be incurred. The provision is cleared by expenditure. No additional income, or gains and losses, are recognised. The resulting deficit of CX25 in restricted reserves is transferred to unrestricted reserves, an identical final outcome to option 1.

| Dr | Cr |
|---|---|
| ***Receipt recognised at 2CX=1CY*** | |
| Cash CX100 | Income -restricted CX100 |
| ***Grant expenses at 2.5CX=1CY*** | |
| Expenses - restricted CX100 | Cash CX 100 |
| ***Recognition of obligation to incur futher expenditure*** | |
| Expenses - restricted CX25 | Onerous contract CX25 |
| ***Incurring additioanl expenditure to clear obliation*** | |
| Onerous Contract CX25 | Expenses - resticted CX25 |
| Expenses - restricted CX25 | Cash CX25 |
| ***Movement between reserves*** | |
| Funds without restrictions CX2 | Funds with restrictions CX25 |
| ***Grant recognised by donor Y at 2.5CX=1CY*** | |
| Grant expenses CY50 | Cash CY50 |

| | Restricted | Unrestricted | Total |
|---|---|---|---|
| **Statement of income and expenses** | | | |
| Income | 100 | | 100 |
| Expenses | -125 | | -125 |
| Operating surplus/(deficit) | -25 | 0 | -25 |
| Surplus/(deficit) | -25 | 0 | -25 |
| **Statement in changes in net asset** | | | |
| Surplus/(deficit)) | -25 | 0 | -25 |
| Movement between reserves | 25 | -25 | 0 |
| Closing balance | 0 | -25 | -25 |
| **Statement of financial position** | | | |
| Overdraft | 0 | -25 | -25 |

# Scenario 2 – Partial refund due to change in rates

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This scenario has the same background as Scenario 1. However, the grant is for X to incur expenditure against a specific project with a measured outcome. X expects to incur expenditure of CX100 against the project. The grant specifies that any amounts not spent on the project must be returned to the grantor. Since there is a measurable performance condition, the grant is deferred as a BGA obligation

**How should refund liability reflected in the Statement of Income and Expenses?**

**Option 1 – Refund liability considered a remeasurement of the BGA liability**

- As it arises from terms of contract, refund liability could be charged to gains and losses. This approach would be consistent with that applied under Option 1 for Scenario 1.
- Since the loss is charged to unrestricted income, there will be a net deficit in unrestricted income, and no deficit or surplus in restricted income. As a result, no transfer in reserves is required.

**Option 2 - Refund liability separate from BGA liability**

- If, in nature, it is a partial refund of income received, then the liability recognised would result in a reduction of income recorded.
- This approach results in a net deficit in restricted income, which is subsequently transferred in reserves to unrestricted income.

# Scenario 2 – Partial refund resulting from change in rates

## Option 1 – Liability considered a remeasurement of the BGA liability and refund charged to gains/losses

The liability to repay is recognised as a remeasurement of the BGA obligation, with a corresponding charge to other gains and losses, similar to Scenario 1. This results in a net deficit in unrestricted income. There is no surplus or deficit in restricted income and hence no movement in reserves is required.

| Dr | Cr |
|---|---|
| ***Receipt recognised at 2CX=1CY*** | |
| Cash CX100 | BGA obligation CX100 |
| ***Revaluing receipts in advance at reporting date 2.5CX=1CY*** | |
| Other gains/losses CX25 | Grant liability CX25 |
| ***Grant expenses at 2.5CX=1CY*** | |
| Expenses - restricted CX100 | Cash CX 100 |
| BGA Obligation CX100 | Income - restricted CX100 |
| ***Settling the remaining grant liability*** | |
| Grant liability CX25 | Cash CX25 |
| ***Grant recognised by donor Y at 2.5CX=1CY*** | |
| Grant expenses CY40 | Cash CY40 |
| ***Grant recognised by donor Y at 2.5CX=1CY*** | |
| Grant expenses CY40 | Cash CY40 |

| | Restricted | Unrestricted | Total |
|---|---|---|---|
| **Statement of income and expenses** | | | |
| Income | 100 | | 100 |
| Expenses | -100 | | -100 |
| Operating surplus/(deficit) | 0 | 0 | 0 |
| Other gains/(losses) | 0 | -25 | -25 |
| Surplus/(deficit) | 0 | -25 | -25 |
| **Statement in changes in net asset** | | | |
| Surplus/(deficit)) | 0 | -25 | -25 |
| Movement between reserves | 0 | 0 | 0 |
| Closing balance | 0 | -25 | -25 |
| **Statement of financial position** | | | |
| Overdraft | 0 | -25 | -25 |

# Scenario 2 – Partial refund resulting from change in rates

## Option 2 – Liability separate from BGA liability and refund reduces income

When the expenditure is incurred, the need to repay is crystallised and a creditor recognised. A corresponding reduction in income is recorded, reflecting the partial return of funds to the donor. The resulting deficit in restricted income is transferred to unrestricted income, similar to Scenario 1.

| Dr | Cr |
|---|---|
| ***Receipt recognised at 2CX=1CY*** | |
| Cash CX100 | BGA obligation CX100 |
| | |
| ***Grant expenses at 2.5CX=1CY*** | |
| Expenses - restricted CX100 | Cash CX 100 |
| BGA Obligation CX100 | Income - restricted CX100 |
| | |
| ***Recongnition of grant reayment liability*** | |
| Income - restricted CX25 | Grant creditor CX25 |
| | |
| ***Settling the remaining grant liability*** | |
| Grant creditoir CX25 | Cash CX25 |
| | |
| ***Movement between reserves*** | |
| Funds without restrictions CX2! | Funds with restrictions CX25 |
| | |
| ***Grant recognised by donor Y at 2.5CX=1CY*** | |
| Grant expenses CY40 | Cash CY40 |

| | Restricted | Unrestricted | Total |
|---|---|---|---|
| **Statement of income and expenses** | | | |
| | | | |
| Income | 75 | | 75 |
| Expenses | -100 | | -100 |
| Operating surplus/(deficit) | -25 | 0 | -25 |
| | | | |
| Surplus/(deficit) | -25 | 0 | -25 |
| | | | |
| **Statement in changes in net asset** | | | |
| | | | |
| Surplus/(deficit)) | -25 | 0 | -25 |
| Movement between reserves | 25 | -25 | 0 |
| | | | |
| Closing balance | 0 | -25 | -25 |
| | | | |
| **Statement of financial position** | | | |
| Overdraft | 0 | -25 | -25 |

# Scenario 3 – Reduced reimbursement due to change in rates

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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. The grant obligation is for X to incur expenditure against a specific project and only expenses incurred will be reimbursed, up to the limit of CY50. It is uncertain how much expenditure X will incur against this project.

X incurs grant related expenditure of CX100 on 1 January 20X3, when the exchange rate is CX2 = CY1.
The agreement specifies that **grant related expenditure is measured against the grant at the spot rate when the expenses are incurred**. Y reimburses the expenditure on 1 June 20X3, when the exchange rate is 1.5CX = 1CY

**How should impact of change in exchange rates on the grant receivable be recorded?**

Receivable is a monetary asset

- Should be translated in accordance with Section 30 of *IFRS for SMEs* and gains and losses recorded in foreign exchange gains or losses.
- The grant donor usually does not accept foreign exchange exposure on monetary items held by the NPO. As a result, foreign exchange gains or losses should be recorded in unrestricted income and expenses, unless the grant specially requires otherwise.

# Scenario 3 – Reduced reimbursement due to change in rates

**Reduction in receivable charged to foreign exchange gains/losses**

The grant receivable is denominated in CY, once the expenditure has been incurred. The receivable has a value of CY50 and is initially recorded by X as CX100, the spot rate on that date.

When the receivable is settled, it has been revalued to CX75, as a result of the change in exchange rates. The reduction in value is charged to foreign exchange loss, in accordance with Section 30 of *IFRS for SME*, as the receivable is a monetary asset.

There is no surplus or deficit in restricted income and hence no transfer between reserves is required. There is a deficit in unrestricted income, as a result of the foreign exchange loss.

| Dr | Cr |
|---|---|
| ***Grant expenses at 2CX=1CY*** | |
| Expenses - restricted CX100 | Cash CX 100 |
| Grant receivable CX100 | Income - restricted CX100 |
| | |
| ***Revaluing grant receivable at reporting date 1.5CX = 1CY*** | |
| Foreign exchange loss CX25 | Grant receivable CX25 |
| | |
| ***Settling grant receivable at 1.5CX = 1CY*** | |
| Cash CX75 | Grant receivable CX75 |
| | |
| ***Grant regcognised by donor Y at 2CX=1CY*** | |
| Grant expenses CY50 | Cash CY50 |

| | Restricted | Unrestricted | Total |
|---|---|---|---|
| **Statement of income and expenses** | | | |
| Income | 100 | | 100 |
| Expenses | -100 | | -100 |
| Operating surplus/(deficit) | 0 | 0 | 0 |
| Forex loss | | -25 | -25 |
| Surplus/(deficit) | 0 | -25 | -25 |
| **Statement in changes in net asset** | | | |
| Surplus/(deficit)) | 0 | -25 | -25 |
| Movement between reserves | 0 | 0 | 0 |
| Closing balance | 0 | -25 | -25 |
| **Statement of financial position** | | | |
| Overdraft | 0 | -25 | -25 |

# Overall Conclusions

## Grant paid in advance (Scenarios 1 and 2)

| | |
|---|---|
| **Option 1** (Scenarios 1&2) Change in BGA obligation charged to other gains and losses | • Exchange rate impacts arising from grant requirements recognised in other gains and losses in the Statement of Income and Expenses<br>• Complications in income recognition due to change in value of BGA |
| **Option 2** (Scenarios 1&2) Onerous contract provision recognised and charged to restricted expenses | • Exchange rate impacts arising from grant requirements recognised as movements in reserves.<br>• Transfer from restricted to unrestricted funds represents the shortfall or surplus arising from the change in exchange rates.<br>• Resulting net deficit in restricted income is subsequently transferred through reserves to unrestricted income. |

**Option 2 is less complex to apply under both Scenarios 1 & 2, and provides a consistent perspective on exchange rate impacts via movements in reserves. Separate disclosure of these movements would be required for transparency.**

## Grant paid in arrears (Scenario 3)

Exchange rate impacts in Scenario 3 relate to the translation of monetary items and are recorded in accordance with Section 30 of *IFRS for SMEs*, **which does not require amendment for INPAG.**

# Appendices

**1) Alternative methods of measuring grant expenditure**

**2) Exchange rate impacts on grant receipts**

# Appendix 1: Alternative methods of measuring grant expenditure

In the three scenarios presented, grant expenditure is measured at the exchange rate when the expenditure is incurred. The impacts of other potential measurement methods are considered below.

## Exchange rate on the date the grant is paid

Should remove most exchange rate exposure from the NPO and should not result in foreign currency translation impacts requiring additional guidance in INPAG

- If the grant is paid in advance, the NPO can eliminate any exchange rate impacts by converting the receipt to its functional currency at the spot rate when the grant is paid, or as close a rate as is achievable in practice.
- If the grant is reimbursed in arrears, it only becomes denominated in the currency of the grant when it is settled, removing any exchange rate exposure from the NPO.

## Predetermined rate defined in the grant agreement

If the grant has a predetermined exchange rate, the grant is, in effect, a transaction in the currency of the NPO. It may be an onerous contract or favourable contract, depending on the spot rate when the grant is settled. The NPO should account for any favourable or onerous element of the grant in accordance with Section 30 – *Revenue* and the specific terms of the grant.

# Appendix 2: Exchange rate impacts on grant receipts

Where a grant is denominated in a currency other than the functional currency of the recipient NPO, the NPO has an obligation to incur expenses equal to the value of the grant, measured in the currency of the grant.

- If expenditure in other currencies is measured at the spot rate when incurred, then if exchange rates movements are adverse, the obligation to incur expenses will increase in the functional currency of the NPO.
- If the grant is paid in the currency it is denominated in, the NPO could operate a foreign currency bank account and retain the grant in its original currency until it is required to fund grant expenditure. This will result in a translation gain on this foreign currency cash, offsetting the increase in obligation to incur additional expenditure.
- Or the NPO may convert the receipt into its functional currency immediately. In this event, the NPO will bear the economic exposure for the impact of changes in exchange rates on its obligation to incur grant expenses.
- Any gain on the cash held by the NPO will be accounted for, as a monetary asset, as set out in Section 30 of IFRS for SME. This will be distinct from the effect of changes in exchange rates on the obligation to incur grant expenses. As a result, accounting for the impact of changes in exchange rates on grant obligations can be considered separately from the impact of exchange rates on this monetary asset.
- Therefore, gains or losses arising on this monetary asset, or any hedging instrument, should be reported in unrestricted income unless the terms of the grant specifically require otherwise.