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Technical Advisory Group Issue Paper

AGENDA ITEM: TAGED12-04
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ED2 Update – Section 30 *Foreign Currency Translation*

Summary	This paper sets out amendments proposed to Section 30 *Foreign currency translation*, and associated application and implementation guidance, following feedback from TAG members.
Purpose/Objective of the paper	To seek TAG's views on the specific amendments proposed following TAG feedback on this section and also to incorporate feedback on the other sections proposed to be included in ED2 that might affect Section 30.
Other supporting items	TAGED12-02 Revenue
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Actions for this meeting	**Comment and advise** on: (i) The revised proposal that all foreign exchange gains and losses arising from binding grant arrangements or funding arrangements are presented as 'with restrictions' in the Statement of Income and Expenses (ii) the updates to Section 30 Core Guidance, Application Guidance that reflect TAG feedback on monetary and non-monetary items (iii) The impact of this approach in illustrative examples (iv) The supporting reasoning in the Basis for Conclusions

Technical Advisory Group

ED2 Update - Section 30 *Foreign currency translation*

1. **Background**

1.1 At the TAG meeting on 28 February 2023, an initial proposal for the approach of foreign currency translation to NPOs was presented. This approach was subsequently shared at the PAG meeting on 8 March 2023. Feedback from those meetings focused on the complexity of the proposed solution and questioned some of the proposed accounting for the impact of changes in exchange rates on an NPO's expenditure obligations arising from a grant.

1.2 Consequently, a snapshot of an alternative approach (option 2) was presented at the TAG meeting on 28 March 2023. This compared key principals in the alternative approach to those of the original approach presented in February.

1.3 TAG were overwhelming in favour of the alternative option and this has been reflected in the updated drafts. Other specific comments were received from the TAG on the drafts provided. In addition comments were received from TAG members on other Sections proposed to be included in ED2, which have flow on impacts to the proposals, particularly around a desire for simplicity.

1.4 As a result, revisions have been made to the authoritative text, together with amendments to the Implementation Guidance and Basis for Conclusions.

2. **Authoritative guidance**

Core text

2.1 Section 30 has been modified to include one additional presentational requirement compared to the *IFRS for SMEs* Accounting Standard. The additional requirement is that exchange gains or losses on monetary items shall be presented as 'with restrictions' in the Statement of Income and Expenses. This requirement is not needed in the *IFRS for SMEs* Accounting Standard as it does not require fund accounting, with its consequential presentational split of items between those 'with restrictions' and those 'without restrictions'.

2.2 The additional requirement to separately disclose the impact of changes in exchange rates on grants has been updated. It is proposed that the impacts of changes in exchange rates on permanent deficits or surpluses on binding grant arrangements or funding arrangements are disclosed separately from deficits or surpluses arising for other reasons. The separate disclosure will provide a means of disclosing these exchange impacts in the financial statements.

2.3 In addition to the feedback specifically on Section 30, consideration has been given to feedback on other sections, particularly Section 23 *Revenue.* As set out in TAGED12-02 it is proposed that in addition to binding grant arrangements another type of grant arrangement, a funding arrangement, is defined. A funding arrangement is a grant arrangement that has limitations rather than compliance obligations. Some of the presentational issues proposed to be addressed in Section 30 related only to binding grant arrangements and not to other grant arrangements (i.e. those that do not have compliance obligations). Consequential amendments have now been made.

2.4 In developing the proposals in TAGED12-02, clarification has been provided that binding grant arrangements and funding arrangements are to be presented as 'with restrictions' in the Statement of Income and Expenses. Section 30 and the associated guidance has been updated to reflect this proposal.

2.5 Paragraph G30.12 has been redrafted as a consequence of the changes outlined above. This paragraph sets out the requirements for presenting the impact of exchange rate gains and losses on the Statement of Income and Expenses, and provides an exception for exchange rate differences that arise from monetary items forming part of a reporting NPO's net investment in a foreign operation. The Secretariat would welcome TAG advice on the likelihood of this exception being used.

2.6 References to the inclusion of exchange rate gains and losses 'within the equity component' in the Statement of Changes in Net Assets have been updated. These now either say 'within component of net assets' or more specifically 'funds without restrictions' as appropriate.

2.7 Excerpts from the revised text are shown in Annex A.

Question 1: Do TAG members agree with the requirement to present exchange gains or losses on monetary items as 'with restrictions' in the Statement of Income and Expenses where they relate to binding grant arrangements or funding arrangements?

Question 2: Do TAG members agree with the requirement to separately disclose the impact of exchange rates changes on binding grant arrangements or funding arrangements? Do TAG members consider these requirements disproportionally complex or time consuming, in relation to the benefit of increased transparency.

Question 3: Are TAG members aware of any circumstances where the exception in G30.15 would be required?

Application Guidance

2.8 The Application Guidance has also been redrafted to reflect the feedback from the TAG, with excerpts showing the main changes also in Annex A. The principal points addressed in this guidance are:

- Binding grant arrangement liabilities are non-monetary liabilities. This is consistent with the proposals in Section 23 *Revenue* and Section 24 Part I *Expenses on grants and donations.*
- Increases in expenditure obligations, as a result of changes in exchange rates, are recognised as provisions, with a corresponding increase in expenses presented as 'with restrictions' in the Statement of Income and Expenses.
- Obligations to repay grant-providers where funds have been received in advance are recognised as a refund liability, with a corresponding decrease in revenue presented as 'with restrictions' in the Statement of Income and Expenses.
- Decreases in the amount of expenditure required to be spent as a result of changes in exchange rates are recognised through the resulting reduction in the amount of expenditure incurred.
- Exchange gains or losses on monetary items relating to binding grant arrangements are presented as 'with restrictions' in the Statement of Income and Expenses.

Question 4: Do TAG members agree that binding grant arrangement liabilities are non-monetary items?

Question 5: Do TAG members agree with the proposed treatment of the impact of changes in exchange rates on grant expenditure obligations?

3. Implementation Guidance

3.1 The illustrative examples in the Implementation Guidance have been modified to reflect the changes to the authoritative text outline above.

3.2 In addition, an example showing the impact of changes in exchange rates on grant revenue that has been retained in foreign currency has also been included. This additional example, which was requested at the 28 March TAG meeting, provides an illustration of the difference in accounting arising from changes to exchange rates with different approaches to foreign currency management.

3.3 The updated Implementation Guidance is attached as Annex B.

Question 6: Do TAG members agree with the approaches set out in the illustrative examples for recording the impact of changes in exchange rates under grant arrangements?

4. Basis for Conclusions

4.1 The Basis for Conclusions has also been updated (see Annex C) to reflect the discussion of the TAG to provide:

- an explanation of why exchange gains and losses on monetary items relating to binding grant arrangements funding arrangements are presented as ‘with restrictions’ in the Statement of Income and Expenses, unless the agreement specifies otherwise.
- the reasoning for binding grant agreement liabilities being non-monetary liabilities.
- the reasoning for recognising a provision where expenditure obligations increase.

Question 7: Do TAG members agree with the supporting reasoning set out in the basis for conclusions?

5. Next steps

5.1 The feedback from the TAG will be reflected in the final version of the draft Section for publication.

May 2023

Notice

Annex A – Excerpts from Section 30 *Foreign currency translation*

G30.5 The following additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting NPO (the reporting NPO, in this context, being the NPO that has the foreign operation as its **controlled entity**, branch, **associate** or **joint arrangement**):

(a) whether the activities of the foreign operation are carried out as an extension of the reporting NPO, instead of being carried out with a significant degree of autonomy. An example of the former is when the foreign operation only sells goods imported from the reporting NPO and remits the proceeds to it. An example of the latter is when the operation accumulates cash and other **monetary items**, incurs **expenses**, generates **income** and arranges borrowings, all substantially in its local currency.

(b) whether transactions with the reporting NPO are a high or a low proportion of the foreign operation's activities, including funding provided by the NPO to the foreign operation in the form of grants, donations and similar income .

(c) whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting NPO and are readily available for remittance to it.

(d) whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations or operating expenses without funds being made available by the reporting NPO, either in the form of loans or grants, donations and similar income.

Replacement of the sections, which related to retranslation of binding grant arrangement liabilities, with the following. This clarifies the presentation of monetary items relating to binding grants arrangements and funding arrangements:

G30.12 Exchange rate exchange gains or losses on monetary items related to binding grant arrangements or funding arrangements (grant arrangements), such as grant receivables, cash received and held in foreign currency and grant payables shall be presented as 'with restrictions' in the Statement of Income and Expenses, except as described in paragraph G30.15, unless the agreement specifies that such gains or losses should not form part of the grant arrangement.

G30.15 Exchange differences arising on a monetary item that forms part of a reporting NPO's net investment in a foreign operation shall be recognised in surplus or deficit in the **separate financial statements** of the reporting NPO or the individual financial statements of the foreign operation, as appropriate. In the financial statements that include the foreign operation and the reporting NPO (for example, **consolidated financial statements** when the foreign operation is a controlled entity), such exchange differences shall be recognised in the Statement of Changes in Net Assets and reported as a component of ~~equity~~ funds without restrictions. They shall not be recognised in surplus or deficit on disposal of the net investment.

Inclusion of a new disclosure requirement that sets out the need to separately disclose transfers between restricted funds and funds without restrictions arising from the impact of change in exchange rates on binding grant arrangements. This replaces the proposed additional presentation requirement for separate presentation of exchange gains and losses and other gains and losses.

G30.30 Permanent deficits or surpluses on individual binding grant arrangements or funding arrangements arising as a consequence of the impact of changes in exchange rates shall be disclosed. These deficits or surpluses shall be disclosed separately from deficits or surpluses arising for other reasons.

Application Guidance – Main revisions

Application Guidance sections AG30.13 and AG30.15 – AG30.20 have been redrafted to reflect the proposed changes.

AG30.13 The exchange rate differences arising from retranslation of binding grant arrangement or funding arrangement (grant arrangement) monetary items, such as grant receivables or grant payables, shall be recorded as 'with restrictions' in the Statement of Income and Expenses in accordance with G30.12, unless the grant arrangement excludes such gains and losses. The underlying principle is that the exchange difference should be follow the presentation of the transaction to which it relates.

AG30.16 Payments made in advance by grant-providers under a binding grant arrangement that has unfulfilled compliance obligations (binding grant arrangement liabilities) are non-monetary items.

AG30.17 Where grantors or donors do not accept exchange rate risk, exchange rate gains and losses will ultimately be funded by the NPO from its funds without restrictions. Such gains or losses shall be presented as 'with restrictions' in the Statement of Income and Expenses, so that any deficit on the grant arrangement is transparent unless in rare cases a grant arrangement prevents this presentation. In these cases they shall be presented as 'without restrictions' in the Statement of Income and Expenses.

AG30.18 If a compliance obligation increases, or a new obligation under a grant arrangement is recognised due to the effect of changes in exchange rates, the additional obligation is recognised as a provision (onerous contract) in accordance with Section 21 *Provisions and contingencies*. The corresponding expense shall be presented as 'with restrictions' in the Statement of Income and Expenses.

AG30.19 If the impact of the change in exchange rates is to require a refund to the grantor or donor, the refund shall be a reduction to revenue presented as 'with restrictions' in the Statement of Income and Expenses. If insufficient revenue has been recognised under the grant arrangement, the balance shall;

(i) be deducted from the binding grant arrangement liability for the unfulfilled compliance obligations relating to binding grant arrangements arrangement.

(ii) create a liability and a new expense relating to limitations under a funding arrangement that will be presented as 'with restrictions' in the Statement of Income and Expenses.

AG30.20 The terms of the binding grant arrangement may require the NPO to spend all the money it received under a binding grant arrangement, including any exchange gains on specified activities, even if all compliance obligations have been met. This requirement, shall have no impact on the reported results of the NPO as it relates to future spend.

AG30.21 Exchange gains or losses arising from grant arrangements, to the extent that they have not been offset by any other impacts unrelated to a change in exchange rates, shall be transferred from funds with restrictions to funds without restrictions as part of any surplus or deficit on each grant arrangement. Transfers should be recognised only when the funds no longer meet the definition of restricted funds under G2.74.

AG30.22 If a grant arrangement does not specify the treatment of exchange rate gains or losses, the NPO shall consider if there are any implied terms, derived from previous agreements or discussions with the donor or grantor. In the absence of any terms, written or implied, surpluses relating to exchange gains shall be presented consistently with the revenue and expenses under the grant arrangement.

The following section has been added to the application guidance to provide guidance on the additional disclosure requirement added in G30.30.

AG30.27 G6.5 sets out requirements for NPOs to disclose an explanation of movements between funds with restrictions and funds without restrictions. Where movements between these funds arise as a result of changes in exchange rates on binding grants arrangements or funding arrangements, these movements shall be separately presented from all other movements, as required by G30.30.

Annex B Updates to the Implementation Guidance – principal changes

Example 2, scenario b) and c) and Example 4 are changed significantly to reflect the alternative option. The revised versions are presented without mark ups to aid review. Example 5 has been added to show the impacts when the grant received is held in the original currency until the expenses need to be paid. The principles in these examples apply to the other examples:

Example 2 – Funding arrangement - Grant received in advance

The functional currency of X is CX. On 1 January 20X3, NPO X receives a grant of CY50 from donor Y, when the exchange rate is 2CX = 1CY. X converts the grant into CX100 on the day of receipt.

The grant imposes limitations on NPO X to incur expenditure on a designated project but the arrangement does not create a compliance obligation. The grant is recorded as revenue on receipt and presented as 'with restrictions' in the Statement of Income and Expenses. All of the funds provided under the funding arrangement will be spent on the project.

b) Grant related expenditure is measured at the spot rate when expenditure is incurred

Recognition of grant receipt as revenue
The grant revenue must be spent on a designated project, and so it is recorded as 'with restrictions' on the Statement of Income and Expenses.

1 January 20X3	Debit	Credit
Cash	CX100	
Revenue – 'with restrictions'		CX100

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

1 June 20X3	Debit	Credit
Expenses – 'with restrictions'	CX100	
Cash		CX100

Recognition of grant obligation
Although NPO X is spending the converted funds, under the terms of the funding arrangement it has only spent CY40 of the CY 50 provided (the spot rate was 2.5CX = 1CY when the expenditure was incurred so that the CX100 spent equated to 40CY). As the funding arrangement specifies that expenses are measured at the exchange rate when the expenses are incurred, NPO X has an obligation to spend a further CY10 of expenses on the project. NPO X creates a provision for an onerous contract to recognise the requirement for this additional expenditure. The provision is denominated in CY and initial recognised at the spot rate on 1 June 20X3 (10CY = 25CX at 2.5CX = 1CY). The corresponding charge is presented as 'with restrictions' in the Statement of Income

and Expenses (AG30.18).

1 June 20X3	Debit	Credit
Expenses – 'with restrictions' – on creation of provision	CX25	
Provision - creation		CX25

Clearing the additional grant obligation
To meet the funding arrangement requirement, NPO X has to spend a further CX25, which it incurs on 1 July 20X3. The spot rate on 1 July 20X3 is also 2.5CX = 1CY.

1 July 20X3	Debit	Credit
Expenses – 'with restrictions' – on spend	CX25	
Cash		CX25
Provision - utilisation	CX25	
Expenses – 'with restrictions' – on utilisation of provision		CX25

The change in exchange rate results in NPO X incurring CX25 more expenditure than was received as revenue.

From the perspective of donor Y, NPO 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.
Movement between reserves
The change in exchange rate has resulted in additional expenditure that then creates a deficit of CX25 on the funding arrangement. Without additional funds from the grant-provider the deficit must be funded from the NPO's funds that have no restrictions. This shortfall needs to be addressed on 1 July 20X3.

1 July 20X3	Debit	Credit
Funds without restrictions	CX25	
Funds with restrictions		CX25

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

1 July 20X3	**With restrictions CX**	**Without restrictions CX**	**Total CX**
Statement of income and expenses			
Revenue	100	0	100
Expenses	(125)	0	(125)
Surplus/(deficit)	(25)	0	(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			
Overdraft/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 needed to incur CX75 under the funding arrangement to have grant expenses of CY50. This exchange rate would have reduced the amount that NPO X needed to spend, leaving NPO X with a cash surplus of CX25.

For this funding arrangement, revenue would exceed expenditure by CX25. Once the terms of the funding arrangement had been fully satisfied, this surplus if not offset by any other relevant transactions (specific only to that funding arrangement), would be available for other activities determined by NPO X. The surplus would not be restricted and so NPO X would record a transfer between funds with restrictions and funds without restrictions of CX25 on 1 June 20X3.

From the perspective of donor Y, NPO X would have incurred expenditure of CY50, being CX75 measured at the spot rate of 1.5CX = 1CY on the date the expenditure is incurred

1 June 20X3	**With restrictions CX**	**Without restrictions CX**	**Total CX**
Statement of income and expenses			
Revenue	100	0	100
Expenses	(75)	0	(75)
Surplus/(deficit)	25	0	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	0

Typically funding arrangements require that the recipient must spend all the revenue they receive on the purpose specified in the grant. If that is the case, NPO X would still need to incur grant related expenditure of CX100 and the outcome would be equivalent to scenario a). That is because the impact of the beneficial change in exchange rates would be overridden by the requirement to spend all revenue received on the designated purpose in the funding arrangement.

From the perspective of donor Y, NPO X would have grant related expenditure of CY67, being CX100 measured at the spot rate of 1.5CX = 1CY on the date the expenditure is incurred.

However, NPO Y would record grant expenditure of CY50, which is the amount of funds provided (AG30.20).

c) Grant related expenditure is measured using a defined rate of 3CX = 1CY

Recognition of grant receipt

Though NPO X receives CX100 in cash on 1 January 20X3, because the agreement imposes an obligation to incur expenditure at the rate of 3CX = 1CY set out in the funding arrangement, NPO X will need to incur expenses of CX150 .

As a result, NPO X records revenue 'with restrictions' of CX100 but at the date the agreement becomes executory, also an onerous contract provision of CX50. This is to recognise the requirement to spend CX150 in total. The creation of the provision is charged to expenses 'with restrictions', as it represents the obligation to incur further expenditure under the funding arrangement (AG30.18).

1 January 20X3	Debit	Credit
Cash	CX100	
Revenue – 'with restrictions'		CX100
Expenses – 'with restrictions' – creation of provision	CX50	
Provision - creation		CX50

Recognition of grant related expenditure and related grant revenue

NPO X incurs grant related expenditure of CX150 on 1 June 20X3, when the spot rate is 2.5CX = 1CY. This uses the revenue received of CX100 and clears the provision of CX50.

1 June 20X3	Debit	Credit
Expenses – 'with restrictions' - spend	CX150	
Cash		CX150
Provision - utilisation	CX50	
Expenses – 'with restrictions' – utilisation of provision		CX50

Movement between reserves

The obligation to spend CX150 as per the funding arrangement has resulted in additional expenditure that then creates a deficit of CX50 on that funding arrangement. This deficit must be funded from the NPO's funds that have no restrictions. This shortfall needs to be addressed on 1 June 20X3.

1 June 20X3	Debit	Credit
Funds without restrictions	CX50	
Funds with restrictions		CX50

NPO X incurs CX50 more expenditure than was received as revenue.

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 funding arrangement

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

1 June 20X3	Restricted CX	Unrestricted CX	Total CX
Statement of income and expenses			
Revenue	100	0	100
Expenses	(150)	0	(150)
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			
Overdraft/cash	0	(50)	(50)

Example 4 – Binding grant arrangement - Grant received in advance

On 1 January 20X3, NPO X receives a grant of CY50 from donor Y under a binding grant arrangement. The exchange rate on receipt is 2CX = 1CY. NPO X converts the grant into CX100 (CY50 = CX100 at a rate of 2CX – 1CY) on the day of receipt.

The binding grant arrangement requires NPO X to incur expenditure on a specific project with measurable performance conditions resulting in a compliance obligation. NPO X expects to incur CX100 of expenditure to meet this compliance obligation. The binding grant arrangement specifies that grant related expenditure is measured at the spot rate on the date when the expense is incurred. Any amounts not spent on the project must be returned to the donor Y.

Recognition of grant receipt as binding grant arrangement liability
As shown in G23.72, a binding grant arrangement liability is recognised when the grant is received.

1 January 20X3	Debit	Credit
Cash	CX100	
Binding grant arrangement liability		CX100

Recognition of grant related expenditure and related grant revenue
NPO X incurs grant related expenditure of CX100 on 1 June 20X3, and is so doing satisfies the compliance obligation. The spot rate on 1 June 20X3 is 2.5CX = 1CY. As the compliance obligation has been met, NPO X recognises revenue 'with restrictions' of CX100.

1 June 20X3	Debit	Credit
Expenses – 'with restrictions'	CX100	
Cash		CX100
Binding grant arrangement liability	CX100	
Revenue – 'with restrictions'		CX100

Measurement of compliance obligations
NPO X has satisfied the compliance obligation. However, under the terms of the binding grant arrangement, expenses incurred by NPO X are measured at the spot rate when they are incurred. Therefore, as defined in the binding grant arrangement, NPO X has incurred expenditure of CY40 on the project (CX100=CY40, at the exchange rate of 2.5CX = 1CY). Therefore, NPO X must return CY10 to donor Y.

NPO X recognises a liability of CY10 at the spot rate on 1 June 20X3. The liability reduces revenue 'with restrictions', as it arises from the obligation to return some of the grant proceeds to the donor (AG30.19).

1 June 20X3	Debit	Credit
Revenue – 'with restrictions'	CX25	
Refund liability to grantor		CX25

Clearing refund liability
NPO X settles the refund liability on 1 August 20X3 by paying CY10 to donor Y. The spot rate on 1 August 20X3 is 3CX = 1CY. As a result, the refund liability is increased by CX5 to CX30 (as CY10 is now CX30 at a rate of 3CX = 1CY). The additional amount required to settle the refund liability to the grantor creates an exchange loss of CX5. This is treated as an exchange loss since the refund liability to the grantor is a monetary item that will result in a cash outflow from NPO X (G30.11). The exchange loss is recognised in revenue 'with restrictions' (G30.12).

1 August 20X3	Debit	Credit
Exchange loss	CX5	
Refund liability to donor – arising from exchange loss		CX5
Refund liability to donor - settlement	CX30	
Cash		CX30

Movement between reserves
The changes in exchange rates collectively result in a deficit of CX30 on the binding grant arrangement. This deficit must be funded from the NPO's funds that have no restrictions. This shortfall needs to be addressed on 1 August 20X3.

1 August 20X3	Debit	Credit
Funds without restrictions	CX25	
Funds with restrictions		CX25

The change in exchange rate results in NPO X incurring CX30 net cash outflow when it repays

CY10 to Donor Y at a rate of 3CX=1C to, settle the grant refund liability.

From the perspective of donor Y, NPO X has incurred grant related expenditure of CY40, being CX100 measured at the spot rate of 2.5CX = 1CY on the date the expenditure is incurred. After recording all the transactions, the impact on NPO X's primary statements is as follows:

1 August 20X3	**With restrictions CX**	**Without restrictions CX**	**Total CX**
Statement of income and expenses			
Revenue	75	0	75
Expenses	(100)	0	(100)
Operating surplus/(deficit)	(25)	0	(25)
Foreign exchange loss	(5)	0	(5)
Surplus/(deficit)	(25)	0	(30)
Statement of changes in net assets			
Surplus/(deficit)	(30)		(30)
Movement between reserves	30	(30)	0
Closing balance	0	(30)	(30)
Statement of financial position			
Overdraft/cash	0	(30)	(30)

Example 5 – Funding arrangement - Grant received in advance and held in foreign currency account

The functional currency of X is CX. On 1 January 20X3, NPO X receives a grant of CY50 from donor Y, when the exchange rate is 2CX = 1CY.. X retains the grant in CY in a foreign currency account.

The imposes limitations on NPO X to incur expenditure on a designated project but the arrangement does not create a compliance obligation. The grant is recorded as revenue on receipt and presented as 'with restrictions' in the Statement of Income and Expenses. All of the funds provided under the funding arrangement will be spent on the project. The funding arrangement specifies that the grant related expenditure is measured against the grant at the spot rate when the expenditure is incurred.

Recognition of grant receipt as revenue
As in example 2b) above, revenue 'with restrictions' is recognised when the grant is received, using the spot rate on 1 January 20X3 to record the revenue and cash.

1 January 20X3	Debit	Credit
Cash	CX100	
Revenue – 'with restrictions'		CX100

Revaluation of foreign currency cash

The cash is revalued to the spot rate on 1 June 20X3, when the spot rate is 2.5CX = 1CY, with a resulting gain of CX25 (as CY50 = CX125 as the spot rate). The re-translation of the cash in the foreign currency account is recorded as an exchange gain. The foreign exchange gain, which results from the retranslation of a monetary item, is recognised as an exchange gain 'with restrictions' in the Statement of Income and Expenses as required by G30.12.

1 June 20X3	Debit	Credit
Cash	CX25	
Foreign exchange gain		CX25

Recognition of grant related expenditure

NPO X incurs grant related expenditure of CX100 on the same date (1 June 20X3). These expenses are funded by converting the holding of CY to obtain CX100. At the spot rate of 2.5CX to 1CY, CY40 is required to provide CX100. This will leave CY10, equivalent to CX25 at the prevailing spot rate remaining. There is no journal to recognise the conversion of the cash from CY to CX, as it has already been revalued to the correct spot rate[1].

1 June 20X3	Debit	Credit
Expenses – 'with restrictions'	CX100	
Cash		CX100

Recognition of grant obligation

As NPO X had retained the cash in a CY account until it was used in line with the funding arrangement, the change in exchange rates between 1 January 20X3 and 1 June 20X3 and the resulting gain on cash held in a foreign currency account means that NPO X has also only spent CY40 of the cash received. The remaining CY10 is still held in a foreign currency account.

As the funding arrangement requires that expenses are measured at the exchange rate when the expenses are incurred, NPO X has an obligation to spend a further CY10 of expenses on the project. NPO X recognises a provision for this additional expenditure. The provision is denominated in CY at the spot rate on 1 June 20X3, with a resulting provision of CX25 (CY10 = CX25 at the spot rate of 2.5CX to 1CY). The corresponding charge is recognised in expenses 'with restrictions' (AG30.18).

1 June 20X3	Debit	Credit
Expenses – 'with restrictions'	CX25	
Provisions		CX25

Clearing additional grant obligation

The spot rate on 1 July 20X3 is 3CX = 1CY, resulting in a revaluation of the provision and the cash

[1] In practice, there would probably be journals to recognise the transfer from one bank account to another.

held in foreign currency. Since both provision and cash have a value of CY10, the gain and loss of CX5 offset.

1 July 20X3	Debit	Credit
Cash	CX5	
Exchange gain – 'with restrictions'		CX5
Provision		CX5
Exchange loss – 'with restrictions'	CX5	

To clear the provision and satisfy the requirements of the funding arrangement, NPO X must spend a further CY10, which it does on 1 July 20X3, converting the remaining CY10 into CX25.

	Debit	Credit
Expenses – 'with restrictions' - spend	CX30	
Cash		CX30
Provision - utilisation	CX30	
Expenses – 'with restrictions' – provision utilisation		CX30

The change in exchange rate results in NPO X incurring CX30 more expenditure than was received as revenue, using reported rates in NPO X's financial statements.

From the perspective of donor Y, NPO X has incurred grant related expenditure of CY50, being CX100 measured at the spot rate of 2.5CX = 1CY and CX30 measured at the spot rate of 3CX = 1CY.

Movement between reserves
Whilst the changes in exchange rates result in additional expenses of CX25, this increase in expenses is offset by the foreign exchange gain. As a consequence there is no surplus or deficit on this funding arrangement and therefore no requirement for reserve movements.

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

1 July 20X3	**With restrictions CX**	**Without restrictions CX**	**Total CX**
Statement of income and expenses			
Revenue	100	0	100
Expenses	(125)	0	(125)
Operating surplus/(deficit)	(25)	0	(25)
Foreign exchange gains/losses	25	0	25
Surplus/(deficit)	0	0	0
Statement of changes in net assets			
Surplus/(deficit)	0	0	0

Movement between reserves	<u>0</u>	<u>0</u>	<u>0</u>
Closing balance	0	0	0
Statement of financial position			
Cash	0	0	0

Annex C Basis for Conclusions

As a number of changes have been made to the Basis for Conclusions, these are presented in full.

BC30.1 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. The PAG strongly supported the inclusion of this topic in INPAG, given the significant practical difficulties experienced by NPOs.

BC30.2 The TAG in its consideration of this feedback sought to understand the nature of the concerns raised. Through these discussions it concluded that the issues being raised were about the application of the accounting principles for foreign currency translation in the NPO context, rather than the principles themselves. This was particularly focused on the presentation and disclosure of foreign currency gains and losses associated with grant funding.

BC30.3 As a consequence it was decided to prioritise this topic for inclusion in INPAG, but to focus on presentation and disclosure. It was agreed not to review the principles for accounting for foreign currency translation in the *IFRS for SMEs* Accounting Standard but instead develop application guidance and implementation guidance.

BC30.4 Reflecting this decision, the draft Third edition of Section 30 of the *IFRS for SMEs* Accounting Standard has been modified to reflect NPO related terminology and the scope of the financial statements proposed for INPAG. It has also been updated to reflect the likely sources of NPO income and expense such as grants and donations. It has not been the subject of a full update.

BC30.5 The main amendments to this Section are to reflect the impact of fund accounting, which is proposed for INPAG. Exchange gains or losses arising on monetary items relating to binding grant arrangements or funding arrangements (grant arrangements) shall be presented as 'with restrictions' in the Statement of Income and Expenses, unless the grant arrangement specifically excludes this presentation.

BC30.6 Consideration was given to showing the exchange gain or loss as 'without restrictions' in the Statement of Income and Expenses particularly to show that an NPO may have to fund a loss from its unrestricted resources. Whilst this has some benefits, it had the potential to create complexity and ultimately not provide the transparency over such gains and losses that is being sought. As a consequence it is proposed that the presentation of the exchange gain or loss follows the presentation of the grant arrangement, which is required to be presented as 'with restrictions' in the Statement of Income and Expenses.

BC30.7 There is a new requirement to separately disclose the impact of changes in exchange rates on grant arrangements where there is a permanent deficit or surplus on the grant arrangement. The requirement to separately disclose these changes in exchange rates is intended to provide transparency of exchange rate exposures relating to grant arrangements. This is important to understanding the source and use of an NPO's funds, which reflects the concerns raised by respondents to the Consultation Paper. The Secretariat recognise that the benefit of this requirement needs to be proportionate to the effort required, particularly for smaller NPOs.

BC30.8 Application Guidance has been developed to provide additional guidance on these key changes to the *IFRS for SMEs* Accounting Standard. This guidance explains that binding grant arrangement liabilities are non-monetary items. This is because they reflect the revenue received or receivable or compliance obligations in a binding grant arrangement that need to be met by the grant recipient. The Secretariat initially considered whether binding grant arrangement liabilities were monetary items, but the INPAG Glossary defines monetary items as units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency. Since no future cash flow is expected to settle these particular liabilities, they are considered a non-monetary item.

BC30.9 As a consequence, binding grant arrangement liabilities measured in a foreign currency are to be recorded at historical cost using the exchange rate at the date of the transaction as set out in G30.10(b). This means that they do not need to be retranslated at each balance sheet date.

BC30.10 The treatment of increased expenditure required to meet the requirements of a binding grant arrangement that arise from exchange rate changes were examined. The Secretariat initially considered whether the additional obligation from the increased expenditure should be classified as a binding grant arrangement liability. As the additional liability does not change the initial revenue recognised and related compliance obligations this was not considered appropriate.

BC30.11 The Secretariat considered instead whether the additional expenditure created an onerous requirement under a binding grant arrangement. It considered whether the recognition criteria for a provision, as set out in G21.4 would be met. As it is likely that the criteria of obligation existence and probable occurrence would be met and the amount of additional expenditure can be reliably measured at the balance sheet date, the Secretariat concluded there would most likely be a present obligation under the grant arrangement. As a consequence a provision for an onerous contract is an appropriate classification. The Secretariat were of the view that the corresponding expense is presented as 'with restrictions' in the Statement of Income and Expenses following the presentation of the original grant arrangement.

BC30.12 The Secretariat considered the situation where the amount of expenditure required to satisfy a grant arrangement is reduced as a result of exchange rate changes impacting the level of expenses in the local currency. Where the grant arrangement requires that the grant recipient must spend all the grant received in the local currency, the NPO will need to incur additional expenses to satisfy the grant arrangement. The additional expenses will be presented as 'with restrictions' in the Statement of Income and Expense.

BC30.13 Where no additional spend is required, if there are no other offsetting transactions, the individual grant arrangement will show a surplus. When the grant arrangement comes to an end, any surplus will be transferred from the specific grant arrangement in funds with restrictions to funds without restrictions. In this way the surplus will become available for any activity undertaken by the NPO.

BC30.14 A scenario of repaying an exchange to the grant-provider was considered. The Secretariat is of the view that a refund is a monetary item and should be distinct from other liabilities under a grant arrangement. It concluded that the repayment should first reduce the amount of any revenue recognised under that grant arrangement and presented as 'with restrictions' in the Statement of Income and Expenses, consistent with the revenue initially recognised.

BC30.15 As it is possible that an exchange gain is greater than the original revenue or greater than the revenue recognised to date (where there are unfulfilled compliance obligations), the Secretariat proposed that where there are compliance obligations to be satisfied, the excess amount should be recognised as a change to the binding grant arrangement liability. The Secretariat were of the view that under a funding arrangement, a repayment to a grant-provider because of an exchange gain would be unlikely. If, however, it is required, the shortfall would be treated as a liability and expense. Any impact on revenue or expense is proposed to be presented as 'with restrictions' within the Statement of Income and Expenses in line with the presentation of the grant arrangement. This presentation will provide transparency about the adequacy of funding.

BC30.15 To illustrate the conclusions reached about the presentation and disclosure of foreign exchange gains and losses, examples have been created. The illustrative examples show how revenue, 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 funds without restrictions in the balance sheet, which is important in understanding the sustainability of NPO finances.

BC30.16 The examples have been framed to provide guidance; to explain how to account for transactions with a different denomination and settlement currency; provide guidance where changes in exchange rates result in differences between revenue received and the obligation to incur costs; to provide guidance on disclosure of exchange rate gains and losses as they relate to grant arrangements; to provide guidance on re-translation of foreign currency monetary assets and liabilities relating to grant arrangements; for the judgements applied in identifying an NPO's functional currency; and to clarify the scope and limitations of the use of a presentation currency other than the function currency.