INTERNATIONAL FINANCIAL REPORTING
FOR NON PROFIT ORGANISATIONS

Technical Advisory Group
Issue Paper

AGENDA ITEM: TAGED13-03
27 June 2023 – Online

Exposure draft Invitation to comment

Summary	This paper provides the first draft of the summary to be included in the invitation to comment.
Purpose/Objective of the paper	The paper identifies the main topics that result from the new text or from adaptations from the *IFRS for SMEs* Accounting Standard. It provides a first draft of the text for each of these topics to explain the main changes and key considerations associated with those changes.
Other supporting items	TAGED13-01 and TAGED13-02
Prepared by	Karen Sanderson
Actions for this meeting	**Advise on** the topics identified, specifically whether these address the main adaptations that are proposed for inclusion in Exposure Draft 2. **Comment on** the description of each of adaptation and particularly whether it addresses the key points that are likely to be of interest to stakeholders.

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Technical Advisory Group

Exposure draft 2 Invitation to comment

1. Introduction

1.1 The invitation to comment is an important part of each exposure draft. It sets out how to respond to the proposals in the Exposure Draft and also provides a high level summary of the key proposals in the document.

1.2 The invitation to comment is particularly important as it is the only part of the Exposure Draft that is translated into other languages. As with ED1 it is proposed to translate the invitation to comment into French and Spanish. The inclusion of the high level summary into the invitation to comment will make the key proposals in ED2 more accessible for French and Spanish language users.

1.3 The invitation to comment will follow the same structure as in ED1, with a summary, invitation to comment, a list of the SMCs, information for respondents, an at a glance guide (that summarises the focus of each section, the degree of change from the *IFRS for SMEs* Accounting Standard and reference to the relevant SMC), an update to the full content of each exposure draft and a list of relevant acronyms.

1.4 As with ED1, the summary will identify each main adaptation, key matters that were considered in reaching the proposal for the adaptation and areas for comment.

1.5 This paper provides the first draft of the summary document[1] in Annex A, which contains:

- an overview of the Exposure Draft and the project
- key issues relating to inventory;
- the main issues relating to revenue;
- the main issues relating to expenses on grants and donations;
- key considerations for foreign currency translation; and
- information about the proposal to remove Section 26 on share-based payments.

2. Summary - overview

2.1 As with Exposure Draft 1, the summary provides an overview of the exposure draft, including background to the project and a summary of the main adaptations that have been made from the *IFRS for SMEs* Accounting Standard that form the proposals in Exposure Draft 2. There are no proposed changes to the structure of the document, with content updated for any changes that have occurred since ED1 was issued as well as the proposals in ED 2.

[1] Note that any text highlighted in yellow will be hyperlinked to the underpinning document

Question 1: Do TAG members consider that there is any additional information needed in the summary that was not in Exposure Draft 1?

3. Revenue

3.1 There are significant changes to the *IFRS for SMEs* Accounting Standard in relation to revenue. This includes new material on revenue from grants and donations that has been drawn from IPSAS 48 *Revenue* as well as from sections of the *IFRS for SMEs* Accounting Standard.

3.2 To cover all of the changes that are included in ED2, it is proposed that the changes are reflected through the description of 7 adaptations. The following themes are proposed:

- The structure of the revenue material in INPAG
- Types of revenue grant arrangement
- Grants and donations - Revenue recognition
- Gifts in-kind
- Services in-kind
- Application and disclosure
- Revenue from contracts with customers

3.3 Summarising the range of adaptations that have been made to revenue risks omitting an adaptation that could be significant for stakeholders or not providing sufficient detail to allow a meaningful understanding of the adaptations proposed.

Question 2: Do TAG members agree with the themes proposed to capture the adaptations to revenue?

Question 3: Do TAG member consider that all of the key issues have been addressed? Are there other adaptations that should be described in the Summary?

4. Expenses on grants and donations

4.1 Unlike the other Sections being included in ED2 there was no previous guidance on expenses on grants and donations in the *IFRS for SMEs* Accounting Standard. The material to create Section 24 has been drawn from IPSAS 48 *Transfer expenses* and as such the whole section is an adaptation from the *IFRS for SMEs* Accounting Standard.

4.2 To cover all of the changes that are included in ED2, it is proposed that the changes are reflected through the description of 3 adaptations. The following themes are proposed:

- Types of grant expense arrangements
- Grant expense recognition
- Enforceable grant arrangements – rights and obligations

4.3 Summarising the proposals in Section 24 into 3 themes risks overly summarising the proposals in ED2 and not providing sufficient detail to allow a meaningful understanding of the adaptations proposed. However, we want to highlight the key points and not to be overly repetitive with the adaptations proposed for revenue, which are often showing the opposite side of a transaction.

Question 4: Do TAG members agree with the themes proposed to capture the adaptations created through the new text on expenses on grants and donations?

Question 5: Do TAG member consider that all of the key issues have been addressed? Are there other adaptations that should be described in the Summary?

5. Inventories

5.1 As there are adaptations that have been made to Section 13 *Inventories*, it is proposed to describe the adaptations in the Summary. There are two main issues that are proposed to be included in a single adaptation related to inventories.

5.2 The first issue to cover relates to the inclusion of permitted exceptions that allow NPOs to not recognise certain kinds of donated inventory. These permissions cover the same issues that are proposed to be outlined in adaptation 4 on gifts in-kind.

5.3 The second issue to cover is the measurement of donated inventory where the IFRS for SMEs Accounting Standard has been adapted to allow inventory to be valued at the lower of cost adjusted for service potential or replacement cost.

Question 6: Do TAG members agree that the adaptations to inventories should be included in the summary and that the proposed text addresses the key issues?

6. Foreign currency translation

6.1 As there are adaptations that have been made to Section 30 *Foreign currency translation*, it is proposed to describe the adaptations in the Summary.

6.2 There are two key adaptations. The first relates to the presentation of exchange gains and losses on the face of the Statement of Income and Expenses as with restrictions or without restrictions. The second relates to the disclosure of exchange gains and losses that have led to a surplus or deficit on an enforceable grant arrangement or prescribed funding agreement.

6.3 There are some further minor amendments to clarify that the currency of grants transactions should be considered in determining the functional currency and to align with terminology used elsewhere in INPAG. It is proposed to only describe the two key adaptations in the Summary.

Question 7: Do TAG members agree that the adaptations to foreign currency translation should be included in the summary and that the proposed text addresses the key issues?

7. Other topics

7.1 In addition to the topics described above there are two other adaptations proposed for inclusion in the Summary. The first relates to Section 6 *Statement of Changes in Net Assets*, where consequential amendments are proposed to describe the disclosures needed where there are transfers between funds with restrictions and funds without restrictions. This is significant because it underlines that INPAG uses fund accounting and is connected to the proposed adaptation for Section 30.

7.2 The second adaptation related to Section 28 *Employee benefits* and Section 26 *Share-based payments.* Section 26 is proposed to be removed and Section 25 to be adapted to remove references to share-based payments and profit sharing. These are important adaptations to highlight as they remove specific for-profit related material from INPAG.

Question 8: Do TAG members agree that the inclusion of the adaptations being made to Section 6, Section 25 and Section 26 should be included in the summary?

Question 9: Does the proposed text addresses the key issues?

8. Next steps

8.1 This summary, as set out in Section 1, is a first draft. It will be further refined to take account of the feedback of TAG members on the final proposed content of ED2, feedback on the SMCs and feedback on the proposed topics for inclusion in the summary from this TAG meeting.

Question 10: Do TAG members agree that the summary contains the key topics relevant to this exposure draft or should there be topics that are added or deleted?

8.2 The invitation to comment document will be completed with the updated summary to be the key feature.

Question 11: Do TAG members have any further questions on the development of the invitation to comment?

June 2023

Annex A

Summary – Exposure Draft 2

Overview

Diagram as per ED1

Objective: Develop the first ever international financial reporting guidance for non-profit organisations (NPOs).

Proposals: The IFR4NPO project sought views, via a Consultation Paper issued in January 2021 on the proposal that the *IFRS for SMEs* Accounting Standard be used as the basis for a single set of authoritative guidance for NPOs.

Having taken account of the feedback from the consultation, adaptations to the *IFRS for SMEs* Accounting Standard are being proposed to create International Non-Profit Accounting Guidance (INPAG) as NPO specific financial reporting guidance.

The first Exposure Draft was focused on the overarching framework for NPO financial reporting and was issued in November 2022. The INPAG Secretariat is currently considering the feedback provided by respondents.

Next steps: The INPAG Secretariat will consider feedback on this Exposure Draft, together with the feedback on the first and the third Exposure Drafts in the development of the final proposals, that collectively will comprise INPAG.

Comment deadline: 31 March 2024

Documents to be reviewed

ED2 – Authoritative Guidance
ED2 – Basis for Conclusions
ED2 – Implementation Guidance

Introduction

In many countries, Non-profit organisations (NPOs) have no guidance or frameworks to support the preparation of financial statements. These are crucial for transparency, accountability and decision making. Funding organisations have filled this void by developing their own reporting requirements for NPOs. While all have their merits, the variety of different requirements can create a heavy burden on the very organisations they want to support.

Private and public sector entities and their stakeholders have benefited greatly from the development and use of international standards since the 1970s. In a 2014 international survey (https://www.ccab.org.uk/international-study-into-financial-reporting-for-not-for-profit-organisations/), which had more than 600 responses from 179 countries, the majority of respondents agreed or strongly agreed that an international accounting standard or guidance specifically for NPOs would be useful.

A Consultation Paper was issued in January 2021 (https://www.ifr4npo.org/cp/), setting out proposals to develop high quality, trusted, internationally recognised financial reporting guidance for NPOs (now called INPAG). It sought feedback on a number of proposals including priority topics. There was overwhelming support for the development of INPAG and the proposals set out in the document.

Objectives

The credibility of NPOs to stakeholders, and particularly those who contribute funds, is dependent on creating and maintaining trust. To strengthen the governance and financial management of NPOs, INPAG is being developed to meet the following three objectives:

Diagram as per ED1

INTERNATIONAL FINANCIAL REPORTING
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Approach to INPAG development

INPAG is being developed through a staged approach. The IFR4NPO project is currently in Stage 1. As part of the Consultation Paper issued in January 2021, stakeholders were asked for their views on the priority topics to be included in Stage 1 of INPAG. Prioritisation is needed to publish INPAG in 2025 within the resources available.

Diagram as per ED1

Conceptual framework

The concepts and pervasive principles that are used in the Exposure Draft of the Third Edition of the *IFRS for SMEs* Accounting Standard (the *IFRS for SMEs* Accounting Standard) have been reviewed to assess whether they are appropriate for NPOs. A number of adaptations have been made to create a framework that is appropriate for NPOs.

A separate conceptual framework developed from scratch for NPOs was considered but the experience of international standard setters is that it can take many years to develop conceptual frameworks. This would have significantly delayed the development of INPAG, and so was not pursued. Instead the concepts and pervasive principles in the *IFRS for SMEs* Accounting Standard have been adapted for the NPO-context.

Core Premises

INPAG is built on the core premises that it is accrual-based and includes guidance on the production of non-financial information.

Accrual based

Accrual-based accounting is required to provide a comprehensive view of an NPO's financial position and activity. It can improve the quality and transparency of financial reports to enhance accountability and decision-making.

Accrual information is accepted as the basis of high quality international financial reporting standards.

Non-financial information

Including non-financial information enables the production of general purpose financial reports. These present management commentary and other narrative reporting alongside the financial information contained in the general purpose financial statements.

General purpose financial reports go beyond the information provided in general purpose financial statements. They provide users with information to allow a meaningful understanding of an NPO's nature, objectives, strategy, risks, and performance.

Delivering INPAG

Approach
The draft INPAG is being developed during 2022 and 2023. This Exposure Draft (ED) is the second of three Exposure Drafts that will be published and taken together will comprise the full INPAG.

Publishing the draft guidance through three Exposure Drafts is intended to make it easier for stakeholders to comment on the proposals, to influence the development of subsequent Exposure Drafts, and to enable consequential amendments based on respondent feedback and conceptual developments to earlier Exposure Drafts.

Whilst it has not been possible to incorporate the feedback from Exposure Draft 1 into this Exposure Draft, some of the proposals in Exposure Draft 1 may be refined in the third Exposure Draft. Any changes made following stakeholder feedback will be made clear.

Diagram as per ED1 (to be updated with revised dates)

INPAG is divided into Sections. These Sections in most cases have the same purpose as the equivalent Section in the IFRS for SMEs Accounting Standard. The Sections may be renumbered in the final guidance if this is helpful to prospective users of INPAG.

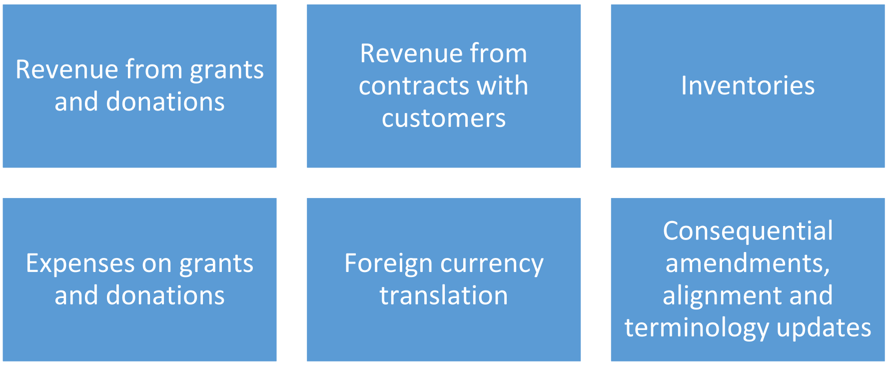
To make it easier to understand the level of change to each Section from the *IFRS for SMEs* Accounting Standard, a status indicator has been added.

Diagram as per ED1 (to be updated to add a new status of removed)

Exposure Draft 2 (ED2)

The focus of ED2 is the key accounting transactions that are relevant for NPO financial reporting. It includes:

Diagram



ED2 is built on the equivalent sections from the *IFRS for SMEs* Accounting Standard or the development of new sections where these do not exist. The contents are listed at the front of ED2 and cover inventories, revenue from grants and donations, revenue from contracts with customers, expenses on grants and donations, foreign currency translations, consequential amendments to some previously exposed sections, and sections requiring alignment or only terminology updates. The preface, sections 1- 10 and a new section 35 (narrative reporting) were published in Exposure Draft 1 (ED1). The remaining sections will be published in Exposure Draft 3 (ED3).

Exposure Draft 1 (ED1) and Exposure Draft 3 (ED3)

ED1 was focused on the overarching framework for NPO financial reporting. This included a description of NPOs and the reporting entity, the concepts and pervasive principles that underpin financial reporting, financial statement presentation, and narrative reporting requirements.

ED3 will focus on fund accounting, the classification of expenses, fundraising costs, and the transition to INPAG. As with ED2 it will include a number of Sections that are updated for terminology or alignment changes but are not updated for other reasons. It will also consider proposals for a supplementary statement to support donor reporting requirements.

Annex B shows the NPO specific content in each Exposure Draft and the expected level of change, together with those Sections that are not expected to be changed other than for terminology changes.

Proposed adaptations

1. Revenue - Determining which guidance to apply

he *IFRS for SMEs* Accounting Standard provides limited guidance on grants and donations. To provide a broader set of revenue guidance, Section 24 *Government grants* has been replaced with guidance based on IPSAS covering all revenue from grants and donations. This guidance is included in an expanded Section 23 *Revenue* which also includes revenue from contracts with customers. To assist NPOs in determining whether a transaction should be accounted for as revenue from grants and donations or revenue from contracts with customers a preface to Section 23 *Revenue* has been developed.

Diagram

The preface explains the different sources of NPO revenue. If the transaction involves the NPO receiving cash, a service, good or other asset from another entity without directly providing cash, a service, good or other asset in return then it should apply Part I of Section 23 *Revenue* which relates to accounting for revenue from grants, donations and similar income.

If the transaction involves the NPO directly providing a service, good or other to a customer in exchange for consideration then it should apply Part II of Section 23 *Revenue* which relates to accounting for revenue from contracts with customers.

Additional guidance in the preface is intended to assist NPOs where it may be necessary to apply both Parts of Section 23 to an individual transaction. The preface also covers the principles of initial recognition of revenue, including the common five step revenue recognition model that applies when there is an enforceable grant arrangement or a contract with a customer, as well as applying principal versus agent considerations.

Proposal development – what else was considered?

A single INPAG Section for revenue and separate INPAG Sections for revenue from contracts with customers and revenue from grants and donations were both considered. Some advisory group members stressed that covering all types of revenue in one section would be preferable while others felt a distinction between 'self-generated' revenue and 'grants and donations' would align itself better to how the sector thinks and talks about revenue.
In the light of these views, a third approach, with all revenue covered in a single section with two Parts, one covering grants and donations and one covering revenue from contracts with customers was deemed preferable. This necessitated the development of a preface to assist NPOs in determining which Part was applicable.

What should I comment on?
It is important that NPOs are able to determine whether they should be applying the guidance for revenue from grants and donations or revenue from contracts with customers to reflect the economic substance of a revenue transaction.

SMC 4a) Do you agree with the structure of Section 23, with Part I focused on grants and donations, Part II focused on contracts with customers and a preface that brings together the key principles as well as information about how to navigate the guidance? If not, what changes would you make and why?

2. Revenue from grants and donations – types of revenue grant arrangements

Revenue from grants and donations have been classified into two types of arrangements; enforceable grant arrangements and funding agreements. This approach follows the approach in IPSAS 47 *Revenue* that distinguishes between binding arrangements and non-binding arrangements. These terms have been adapted to be appropriate for the type of arrangements NPOs have with grantors and donors.

Diagram

An enforceable grant arrangement is a grant arrangement that confers both rights and obligations, enforceable through legal or equivalent means, on both the parties to a grant arrangement. All other arrangements are funding agreements.

An enforceable grant obligation is a grant recipient's undertaking in an enforceable grant arrangement to achieve a specified outcome, to carry out a specified activity, to use distinct services, goods or other assets internally for a specified purpose or to transfer distinct services, goods, cash or other assets to a service recipient. An enforceable grant obligation creates a present obligation for the grant recipient.

In a funding agreement the grant-provider may constrain the use of the resources it has provided, for example, to a certain period of time or geographic area. As these are not sufficiently specific they do not create a present obligation for the grant recipient. Only if an NPO subsequently fails to satisfy the constraint will the NPO have an obligation for which it will need to create a liability.

Proposal development – what else was considered?

Adapting Section 24 of the *IFRS for SMEs* Accounting Standard was considered, but while the principles were appropriate for INPAG, there was insufficient detail to provide the required level of guidance. IPSAS 47, which has consistent principals to Section 24 of the *IFRS for SMEs* Accounting Standard was selected as it has the additional detail appropriate for NPOs. Questions were raised about legal enforceability as in practice this may not be used. INPAG confirms that it is the ability to legally enforce a grant arrangement, and not the exercise of those rights that is important. Also in some jurisdictions, agreements may be enforceable because of possible intervention by the regulator.

What should I comment on?

The extent to which arrangements and the obligations they include are enforceable by both parties may vary between jurisdictions.

SMC 4b) Do you agree that all revenues from grants and donations can be classified as an enforceable grant arrangement or a funding agreement? If not, providing examples of which grants or donation revenue would not fit in either of these classes, why not?
SMC 4c) Do you agree with the definition of an enforceable grant arrangement and its requirements from a grant recipient perspective? If not, what do you see as the practical or other considerations?
SMC 4d) Do you agree with the terminology of enforceable grant arrangement and enforceable grant obligation? If not, what alternative terms to achieve the same meaning would you propose?

3. Revenue from grants and donations –revenue recognition

The existence or otherwise of rights and obligations are used as the basis of recognition for both revenue from grants and donations and for expenses on grants and donations (for those NPOs that provide grants to other entities or individuals see adaptations 8, 9 and 10).

Revenue from enforceable grant arrangements will be recognised when an NPO has met the enforceable grant obligations in the arrangement. This is consistent with when revenue is recognised where an NPO has a contract with a customer. Revenue from enforceable grant arrangements is therefore recognised using the same five step approach as revenue from contracts with customers that is set out in the *IFRS for SMEs* Accounting Standard.

Diagram

The transfer of resources from the grant-provider could occur either before or after the NPO has recognised the revenue. If the enforceable grant obligations are met prior to the transfer of resources by the grant provider, the NPO will recognise an asset. This asset is the NPO's entitlement to the resources before they are due.

If resources are received from a grant-provider prior to the NPO meeting its enforceable grant obligations, the NPO will need to recognise a liability. This liability will reflect the NPO's present obligation to achieve the outcome, deliver the activities, uses the goods or services internally or transfer goods, services or assets externally that are enforceable in the enforceable grant arrangement.

Revenue from funding agreements will usually be recognised at the same time as the asset, which is when the asset is received. This is consistent with both IPSAS 47 and Section 24 of the *IFRS for SMEs* Accounting Standard and conceptually appropriate for NPOs. Some exceptions are proposed to this general principle for donations in-kind.

Proposal development – what else was considered?

Recognition of revenue needs to reflect the substance of the arrangement between the grant-provider and grant recipient. Consideration was given to the level of specificity required for a requirement imposed by a grant-provider to be an enforceable grant obligation. The guidance clarifies that a requirement needs to be distinct and separable from other activities so that it can be separately monitored and it will be clear when the requirement has been met.

What should I comment on?

Applying the requirements of the enforceable grant arrangement model is key to the recognition and measurement of revenue by grant recipients and any associated assets and liabilities. Recognition of revenue on receipt of resources rather than deferring it to match associated expenditure where there is no enforceable grant arrangement may differ from the approach of some jurisdictions.

SMC 4(e) Do you agree that revenue is deferred if the grant recipient has a present obligation in relation to the revenue received? If not, in what other circumstances could revenue be deferred and what is the conceptual basis for this proposal?

4. Revenue from grants and donations –gifts in-kind

The general recognition principles applicable to revenue from grants and donations also apply to gifts in-kind. However, given there can be practical difficulties in recognising and measuring some gifts in-kind, INPAG proposes that NPOs can apply a limited number of permitted exceptions to certain categories of gifts in-kind. These are:

Low value items for resale – NPOs are permitted to not recognise assets or revenue when the items are received, but instead recognise revenue and an asset (generally cash) when the items are sold. These items will be measured at the amount received when the item is sold. This exception is included as the costs of reliably measuring each item on receipt may exceed the value of the information to users of the financial statements.

Items for distribution to service recipients or for its own use – NPOs are permitted to not recognise assets (generally donated inventory) or revenue when the items are received. NPOs are required instead to recognise revenue and an expense when the items are distributed or used, measured at their fair value. As with low value items for resale, the costs of reliably measuring these items on receipt may exceed the value of the information to users of the financial statements. This is particularly the case if the donated items have a short life and the NPO is not be able to use them.

Diagram

Where a gift in-kind cannot be measured reliably, it should not be recorded.

Proposal development – what else was considered?

There was broad acceptance that exceptions for low value high volume donated items is pragmatic given the likely costs to maintain systems to record such items and the likely usefulness of information. However, some wanted to go further for donated inventory for distribution to service recipients, by not recognising revenue at all, even if the item was used. Permitting a broader exception was not considered appropriate where the gift in-kind can be reliably measured and would undermine transparency over the activities of the NPO.

What should I comment on?

Recognising gifts in-kind where possible is important for transparency, although brings practical issues and costs for NPOs. INPAG aims to balance the needs of users of general purpose financial reports and preparers.
SMC 4f) Do you agree with the proposals that allow the recognition of some gifts in-kind either when sold, used or distributed? If not, what would you propose instead and what is the rationale for your proposal?
SMC 4h) Do you agree that the permitted exceptions for donations in-kind cannot be used where donations are received as part of an enforceable grant arrangement? If not, why not?
SMC 4i) Do you agree that donations in-kind (both gifts in-kind and services in-kind) should be measured at fair value? If not, what would you proposed instead?

5. Revenue from grants and donations - services in-kind

As noted under adaptation 4, the general recognition principles applicable to revenue from grants and donations should apply to services in-kind where possible. However, given practical difficulties identified in identifying and/or measuring services in-kind, it is proposed that NPOs would be allowed to apply permitted exceptions.

NPOs are not required to recognise revenue, expenses or assets for any services in-kind except those that are critical to the NPO's mission. Although not required, NPO's are encouraged to recognise services where they provide decision useful information and improve the transparency of the NPO's operations.

Services in-kind that are critical to the NPO's mission must be recognised where the value of the services can be reliably measured. To be mission critical, an NPO would not be able to deliver its services or it would have to materially reduce the level of its activities if it didn't have access to the services in-kind being provided.

Diagram

In addition to these permitted exceptions there is a general exemption for recognition of donations-in-kind when these cannot be measured reliably. Additional disclosures are required where services in-kind that are critical to the NPO's mission cannot be reliably measured. As with gifts in-kind NPOs are encouraged (but not required) to disclose their best estimate of the value of any services in-kind that it has received but not recognised as revenue.

Proposal development – what else was considered?

There were very mixed views about both the practicality of recognising services in-kind and the and the usefulness of the information. PAG members noted the practical difficulties with measuring these items, but other stakeholders were of the view that recognising and measuring services in-kind was important to understanding the operating model of an NPO. Consideration was given to extending the exception to not recognise revenue to all services in-kind. However, particularly where an NPO is dependent on services in-kind, it was considered important for these to be recognised for transparency.

What should I comment on?

Recognising services in-kind is important for transparency, particularly where the donation of services is critical to the operating model of an NPO. However, recognising services in-kind are likely to bring practical issues and costs for NPOs. INPAG aims to balance the needs of users of general purpose financial reports and preparers.

SMC 4g) Do you agree that the recognition of services in-kind should be mandated where they are mission critical? If not, on what basis should services in-kind be recognised in NPO financial statements and what is the rationale for your proposal?
SMC 4i) Do you agree that donations in-kind (both gifts in-kind and services in-kind) should be measured at fair value? If not, what would you proposed instead?

6. Revenue from grants and donations – application and disclosure

Part I has been developed to address the most common types of revenue from grants and donations. To assist NPOs in applying each step in the 5 step model, guidance has been developed, tailored for NPOs. The guidance differentiates between enforceable grant arrangements that have one enforceable grant obligation, and those that have multiple enforceable grant obligations. A simplified approach is proposed where there is a single enforceable grant obligation that avoids work to identify separate enforceable grant obligation and an amount to be recognised when each is met.

Diagram

A key task for NPOs will be to identify each enforceable grant obligation. As revenue will only be recognised as an enforceable grant obligation is met, NPOs will need to be able to measure and/or report progress on how it has satisfied each enforceable grant obligation. Administrative tasks are generally not separate individually enforceable obligations, but a means to identify or report on resources in an enforceable grant arrangement.

Capital grants to construct or purchase a non-current asset can be complex. However, there is likely to be detail about the project that can provide a basis for identifying enforceable grant obligations. This information can also assist in determining appropriate measures of progress. Where an enforceable grant arrangement provides resources both for the purchase of an asset and its subsequent use, there will be separate enforceable grant obligations.

Multi-year arrangements are also covered in the guidance. Where a funding agreement covers multiple years, revenue will be recognised when the resources are transferred to the grant recipient. So if all of the resources are transferred at the beginning of the agreement, the grant recipient will need to recognise them all on receipt.

Disclosures in Part I have been based on the requirements in the *IFRS for SMEs* Accounting Standard and focus on material grant arrangements, significant payment terms and the extent of an NPO's compliance obligations.

Proposal development – what else was considered?

Once IPSAS 47 was determined to be the appropriate base for the revenue from grants and donations, the focus was on adapting the standard for the NPO context. The disclosure requirements in IPSAS 47 are based on IFRS 15 *Contracts with customers* and were considered to be too onerous for NPOs. As a consequence the scaled back requirements in the *IFRS for SMEs* Accounting Standard has been used as the basis for the disclosure requirements.

What should I comment on?

Applying the requirements of the enforceable grant arrangement model is key to the recognition and measurement of revenue by grant recipients and any associated assets and liabilities.

SMC 4j) Do you agree that administrative tasks are generally not separate individually enforceable obligations, but a means to identify or report on resources in an enforceable grant arrangement? If not, provide examples of where administrative tasks are an enforceable obligation.

SMC 4l) Do the proposals for disclosure of grant revenue provide an appropriate level of transparency? If not, what would you propose and what is the rationale for your proposal?

7. Revenue from contracts with customers

Revenue from contracts with customers involves an NPO receiving consideration in exchange for the direct transfer of services, goods or other assets to another entity or individual (a customer). Exchange revenue was not discussed in detail in the Consultation Paper.

The new *IFRS for SMEs* Accounting Standard Section 23 *Revenue from contracts with customers* is based on IFRS 15 *Revenue from contracts with customers*. No NPO-specific issues were identified in respect of exchange revenue, but the new requirements are based on a standard that is more complex than some NPOs will have previously applied.

Amendments to change terminology for the NPO context have been made. In addition authoritative guidance has been added to assist with simpler transactions that are expected to be more common for NPOs. This additional guidance identifies which requirements are not relevant for simpler transactions to improve the ease of use of what is otherwise a relatively complex Section.

Diagram

Whilst Part I focuses exclusively on revenue from grants and donations, it addresses only the most common transactions. For more complex transactions there is additional guidance in INPAG that shows how the principles in Part II can be applied to revenue from grants and donations.

Proposal development – what else was considered?

The proposed amendments to the *IFRS for SMEs* Accounting Standard and developments to IPSAS means that the five step model, with some adaptations, is now consistent across the international accounting frameworks. As the underlying set of principles in accounting for revenue from contracts with customers is the same it was deemed appropriate that that INPAG should also adopt these principles.

What should I comment on?

NPOs need to be able to apply the principles of INPAG. Where the *IFRS for SMEs* Accounting Standard principles are appropriate for NPOs but are complex to apply, INPAG aims to improve ease of use where possible.

SMC 4n) Will the additional guidance for applying the five step revenue recognition model to simpler contracts that NPOs have with improve ease of use of Section 23 Part II. If not, what other simplifications would be helpful?

8. Expenses on grants and donations – types of grant expense arrangements

Expenses on grants and donations have been classified into two types of arrangements; enforceable grant arrangements and funding agreements, adopting the same approach taken to revenue from grants and donations.

An enforceable grant arrangement is a grant arrangement that confers both rights and obligations, enforceable through legal or equivalent means, on both the parties to a grant arrangement. While a grant recipient's required actions in an enforceable grant arrangement create an enforceable grant obligation, for the grant provider it creates a grant fulfilment right.
All other arrangements, including those created through a constructive obligation are funding agreements.

Diagram

In a funding agreement, a grant provider may constrain the use of the resources it has provided. As noted in adaptation 2, if a constraint is not sufficiently specific it does not create a present obligation for the grant recipient, and therefore there is not a grant fulfilment right for the grant provider.

In a funding agreement it is only if the grant recipient subsequently fails to satisfy the constraint that it will have an obligation. At that point, subject to the legal framework of individual jurisdictions, the grant provider will have a right to a return of the transferred resources as they have not been used required.

Grant arrangements can be for capital (where a grant-providing NPO provides resources to a grant recipient to construct or purchase a non-current asset) or operating purposes.

Proposal development – what else was considered?

The extent to which a constructive obligation could exist for NPOs was debated extensively. The consensus was that a constructive obligation to transfer resources that results in the recognition of a provision would require the recognition of a grant expense by the grant-providing NPO. It was noted, that additional guidance was necessary around general statements of intent to provide resources and how this interacts with enforceable grant arrangements.

What should I comment on?

The difference between a constraint in a funding agreement and an enforceable grant obligation in an enforceable grant arrangement has important consequences for the recognition of an asset by the grant-providing NPO when it provides resources to a grant recipient.
SMC 5a) Do you agree that all expenses on grants and donations can be classified as an enforceable grant arrangement or a funding agreement? If not, providing examples of which expenses on grants or donations would not fit in either of these classes, why not?
SMC 5d) Do you agree with the definition of an enforceable grant agreement from a grantor/donor perspective? If not, what do you see as the practical or other considerations
SMC 5g) Do you agree that where the use of resources has been constrained in a funding agreement, a grant-providing NPO will only recognise an asset where the failure to meet the constraint creates a present obligation for the grant recipient? If not, why not? What would you propose instead?

9. Expenses on grants and donations –grant expense recognition

As noted under adaptation 8, the definition of an enforceable grant arrangement is narrower than a funding agreement, as it requires both parties to have enforceable rights and obligations. This allows the rights and obligations to be used as the basis of recognition for both revenue from grants and donations and for expenses on grants and donations.

Where an enforceable grant arrangement exists, a grant expense is recognised by the grant-providing NPO when a grant fulfilment right is met. A grant fulfilment right is each right that the grant-provider has in the enforceable grant agreement, which will be met when the grant recipient has satisfied an enforceable grant obligation. The grant expense will be measured at the amount due for each of the grant fulfilment rights that have been met. A grant-providing NPO will need to agree appropriate measures of progress with the grant recipient to assist in determining when each grant fulfilment rights has been met.

Diagram

There may be timing differences related to the transfer of resources under an enforceable grant arrangement and the meeting of a grant fulfilment right. This may mean that the transfer of resources occurs either before or after a grant expense has been recognised.

If a grant-providing NPO transfers resources prior to the grant recipient meeting its enforceable grant obligation, it derecognises the resources transferred, and recognises a prepayment asset, which represents its right in the enforceable grant arrangement. Conversely, if a grant recipient has met its enforceable grant obligation prior to the grant-providing NPO transferring resources, the grant-providing NPO will have a grant payment obligation and will recognise a liability.

Where there is a funding agreement the recognition and measurement will depend on grant-providing NPO's obligation to transfer resources. A legal obligation to transfer resources will result in the recognition of a liability and a grant expense whereas a constructive obligation will result in the recognition of a provision and a grant expense. Where a grant-providing NPO is not obligated to transfer resources to the grant recipient, a grant expense will be recognised when the resources are transferred to the grant recipient.

Proposal development – what else was considered?

There is no existing guidance in the *IFRS for SMEs* Accounting Standard for expenditure on grants and donations. IPSASB issued IPSAS 48 *Transfer Expenses* in May 2023 and this standard was agreed to be an appropriate base for recognition and measurement of grant expenses.

What should I comment on?

Existing practices on the recognition of grant expenses may differ, particularly where expense recognition is linked to an enforceable grant arrangement, rather than the transfer of resources. These proposals may differ from the approach of some jurisdictions.
SMC 5e) Do you agree that the full amount of the grant (including where it covers multiple years) should be recognised as an expense if the grant-provider has no realistic means to avoid the expense? If not, under what circumstances should a grant-provider not recognise the full expense and what is the rationale?

10. Expenses on grants and donations – enforceable grant arrangements – rights and obligations

Enforceability and identifying distinct grant fulfilment rights and enforceable grant obligations are key to applying the recognition and measurement principles. An enforceable grant arrangement must have at least one grant fulfilment right held by the grant-providing NPO and one enforceable grant obligation required of the grant recipient.

Enforceability can arise from various mechanisms. While these may be through legal systems there may also be alternative processes that have equivalent effect depending on the parties involved and the jurisdictions in which they are based. In certain cases the ability to reduce or withhold future funding may be an enforcement mechanism, as might customary practices.

Diagram

A grant fulfilment right is a distinct right that can be enforced separately from other rights in the enforceable grant arrangement. A grant-providing NPO may aggregate related rights until this produces a distinct grant fulfilment right that can be enforced separately.

When there is only one grant fulfilment right and one enforceable grant obligation the entire grant payment amount will be allocated to that grant fulfilment right. Where an enforceable grant arrangement involves multiple distinct grant fulfilment rights, the grant amount will need to be allocated between each distinct grant fulfilment right to reflect its stand-alone amount.

Grant-providing NPOs will need to consider whether there are requirements attached to its rights that enable it to realistically avoid the transfer of resources. If not, a grant expense measured at the amount related to the associated grant fulfilment right is recognised.

Proposal development – what else was considered?

Whether a requirement to use resources on a grant recipient's overall purpose (non-specific) would be sufficient to create an enforceable grant obligation was considered. It was determined that while such requirements can constrain the use of transferred resources by the grant recipient, they are not sufficient to create a present obligation for the grant recipient when resources are transferred. A present obligation is needed for an enforceable grant obligation.

What should I comment on?

The enforceability of an arrangement by both parties, particularly if not by legal means, is a key consideration in determining if an enforceable grant arrangement exists particularly given the power imbalance that can often exist between grant providers and grant recipients.
SMC 5b) Do you agree that regulatory oversight can be sufficient to create an enforceable grant arrangement? If not, why not? What weight should be applied to regulatory oversight?
SMC 5c) Do you agree that customary practices can be sufficient to create an enforceable grant arrangement? If not, why not? What weight should be applied to customary practices?
SMC 5f) Do you agree that administrative tasks are generally not separate individually enforceable obligations, but a means to identify or report on resources in an enforceable grant arrangement? If not, provide examples of where administrative tasks are an enforceable obligation.

11. Inventories – recognition, measurement and impairment

The recognition and measurement of donated inventories, work-in-progress of services to be provided to service recipients for no or nominal amounts, and its subsequent measurement of inventories were identified as important issues for NPOs.

Proposals for revenue in Section 23 *Revenue* permit NPOs to not recognise revenue for many donated items. The *IFRS for SMEs* Accounting Standard has been amended so that an NPO taking advantage of these permitted exceptions does not recognise inventories in respect of these donated items. Amendment has also been made to allow NPOs to expense the work-in-progress on services to be provided to service recipients for no or nominal amounts as costs are incurred rather than to recognise inventories.

Diagram

A further adaptation has been made to require an NPO to measure inventories held for use or distribution at the lower of cost adjusted for any loss of service potential and replacement cost. This allows NPOs to reliably measure inventories that may be impaired even if a replacement cost if not available.

INPAG includes a rebuttable presumption that donated inventories can be measured reliably. To address concerns that some NPOs would face practical difficulties in some circumstances, this presumption can be rebutted. A narrative description of those inventories that cannot be measured reliably is required. Where a permitted exception has been used, this fact must also be disclosed.

Proposal development – what else was considered?

The need for additional guidance on determining fair value was discussed. Additional guidance permits NPOs to use the cost to the donor where there are no observable inputs and this value is known. A Section on fair value, based on the *IFRS for SMEs* Accounting Standard will be included in Exposure Draft 3.

The addition of a third cost formula, first expired first out (FEFO) was also considered for NPOs who receive donations of perishable items such as food or medical supplies. However, as valuing perishable items is not unique to NPOs this was not progressed.

What should I comment on?

The recognition of measurement of inventories, which are often provided to and then distributed by NPOs at little or no cost, can have significant operational implications.

SMC 2b) Do you agree that donations held for resale are not recognised as inventory? If not, why not?
SMC 2c) Do you agree that the recognition of donated inventory held for use or distribution can be delayed until it is used, when it is recognised as revenue and expensed at the same time? If not, why not?
SMC 2d) Do you agree that fair value should be used to value donated inventory? If not, what would you propose instead?
SMC 2e) Do you agree that inventories held for distribution at no or nominal consideration or for use by the NPO in delivering its objectives shall be measured at the lower of cost adjusted, for any loss of service potential and replacement cost? If not, what would you propose instead?
SMC 2f) Do you agree with the proposal that where permitted exceptions are used and where inventories are not recognised because they cannot be reliably measured that they are disclosed? If not, why not?

12. **Foreign currency translation – presentation and disclosure**

Foreign currency translation was identified as a significant issue in the NPO context, particularly in relation to foreign currency gains and losses associated with grant funding.

Amendments have been made to the *IFRS for SMEs* Accounting Standard so that in most cases exchange rate gains or losses on monetary items related to enforceable grant arrangements and prescribed funding agreements, such as grant receivables, cash held in foreign currency and grant payables are presented as 'with restrictions' in the Statement of Income and Expenses. This establishes the principle that exchange gains and losses follow the presentation of the grant arrangement to which they relate.

The application guidance also clarifies that grant arrangement liabilities, which are an NPO's obligations to meet enforceable grant obligations are non-monetary liabilities. This is significant as it means that these do not need to be retranslated at each reporting date.

INPAG introduces an additional requirement that permanent deficits or surpluses on individual enforceable grant arrangements and prescribed[2] funding agreements arising as a consequence of changes in exchange rates are disclosed. This requirement is intended to provide transparency of exchange rate exposures relating to grant arrangements.

The illustrative examples show the accounting requirements that may result from exchange gains and losses on a range of grant arrangements. This includes the need to create a provision for an onerous arrangement if an NPO is obliged to expend more than the resources it was provided with due to adverse movements on exchange rates.

Proposal development – what else was considered?

Consideration was given to showing the exchange gain or loss on grant arrangements 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 have some benefits, it also had the potential to create complexity in providing the transparency being sought.

Consideration was also given to whether additional spend to cover exchange rate loss in grant arrangements should be classified as a new or additional enforceable grant arrangement liability. This was not considered appropriate as it does not change the initial revenue recognised or related enforceable grant obligations.

What should I comment on?

NPOs can bear significant risk through exchange rate movements. Transparency through appropriate presentation and disclosure is an important issue for the sector.
SMC 10b) Do you agree with the principle that exchange gains and losses are shown as without restrictions unless they relate to a transaction that is to be shown as restricted? If not, why not?
SMC 10c) Do you agree with the need for the exception in G30.15? If not, why not?
SMC 10d) Do you agree with the proposal that exchange gains and losses that contribute to a surplus or deficit on those individual grant arrangements presented as funds 'with restrictions' be disclosed? If not, why not? What would you propose instead?

[2] A prescribed funding agreement is a funding agreement that will be identified in the new section on fund accounting to be provided in ED3 to be presented as funds with restrictions.

13. **Statement of changes in net assets – explanation for reasons for changes resulting from movements between funds with restrictions and funds without restrictions**

ED1 included a proposal to replace the Statement of Changes in Equity that is included in the *IFRS for SMEs* Accounting Standard with a Statement of Change in Net Assets. This statement presents an NPO's funds with restrictions and funds without restrictions and shows how they have changed over the reporting period. It also includes a number of transactions that under the *IFRS for SMEs* Accounting Standard would be part of Other Comprehensive Income.

In developing proposals for ED2, it was determined that because of the importance of funds with restrictions and funds without restrictions in understanding an NPO's financial statements, a consequential amendment to the proposals in ED1 for Section 6 *Statement of Changes in Net Assets* was needed. This is to require NPOs to disclose an explanation of the reasons for movements between funds with restrictions and funds without restrictions. This is intended to help users of the financial statements understand the factors that give rise to such movements such as:

- Transfers from funds without restrictions to funds with restrictions to finance a deficit on material enforceable grant arrangements or prescribed funding agreements.
- Transfers from funds with restrictions to funds without restrictions when the reason for designating an arrangement as with restrictions no longer applies.
- Transfers from funds with restrictions to funds without restrictions in respect of the acquisition of a non-current asset when there are no enforceable grant obligations in respect of the future use of the asset.

Proposal development – what else was considered?

Consideration was given to not making any change to the proposed text in ED1, or to defer making changes to the text until the comments from ED1 had been analysed. It was considered that the clarifications were both required and helpful to be exposed in ED2, particularly to underpin proposed changes to Section 30 Foreign currency translation to help understanding of the proposed changes.

What should I comment on?

Understanding the reasons for transfers between funds is important for accountability, transparency and demonstrating the financial resilience of an NPO.

SMC 1a) Do you agree that transfers between funds should be shown on the Statement of Changes in Net Assets rather than on the Statement of Income and Expenses? If not, why not?
SMC 1b) Does the consequential amendment to Section 6 provide sufficient guidance on transfers between funds? If not, what additional guidance is required?

14. Removal of profit-sharing and share-based payments

The review of the *IFRS for SMEs* Accounting Standard sections on employee benefits and share- based payment to update them for terminology changes, has resulted in more significant changes.

It is proposed to remove Section 26 on share-based payment completely from INPAG. While some NPO's have equity, it is expected that this equity is not traded and does not have a value that is relevant to employees and suppliers.

The characteristics of an NPO require that any surpluses (profits) are used to further the objectives of the NPO and to be used for the benefit of service recipients. For this reason, profit-sharing is not an appropriate remuneration for NPOs and so all references to profit sharing arrangements have been removed from Section 28 of INPAG. References to bonuses have been retained as this might be part of a remuneration structure. The proposed removal of Section 26 *Share-based payment* from INPAG also means that references to share-based payment included in relation to employee benefits have also been removed.

A further amendment has been made with respect to post-employment benefits and the allocation of employee benefit expense. The *IFRS for SMEs* Accounting Standard refers to group arrangements and the possibility that other entities are following other GAAP. This paragraph has been amended to require that the allocation of employee benefit expense can only be made if the controlling NPO is following INPAG. This change has been made as the paragraph is written for a controlling NPO and it if follows that this treatment is allowed only if the NPO is following INPAG.

Proposal development – what else was considered?

The possibility of removing the accounting policy choice for the presentation of in-year changes to the amounts to be recognised for defined benefit pension schemes was considered to simplify the financial statements. The TAG were, however, of the view that removing a policy choice was effectively introducing a rebuttable presumption and with the expectation that few NPOs will have defined benefit pension schemes and those that do may have more complex stakeholders requirements, it was appropriate to maintain the policy choice.

What should I comment on?

Removing aspects of the *IFRS for SMEs* Accounting Standard that are not relevant to NPOs is important in ensuring INPAG's relevance and usability.

SMC 8a) Do you agree that profit sharing and share-based payment are removed from Section 28 *Employee benefits* to reflect that employees of NPOs are not incentivised by sharing in the surpluses made by an NPO? If not, provide examples of profit sharing arrangements used by NPOs.
SMC 8b) Do you agree that in-year changes to the value of post-employment benefits can be shown on either the Statement of Income and Expenses or Statement of Changes in Net Assets? If not, why not?
SMC9a) Given the characteristics of NPOs, do you agree that guidance on share-based payment is not required? If not, provide examples of NPO share-based payment transactions and explain how they are used.

Information for respondents to the consultation

Who should respond?

ED2 is relevant to a range of NPO stakeholders. Responses would be particularly welcomed from:

- Regulators
- Standard setters
- NPOs
- Auditors
- Professional accounting bodies
- Public interest groups
- Finance ministries
- Tax authorities
- Academics
- Funders/donors

Other relevant documents

The Exposure Draft includes:

- Authoritative Guidance for the Sections in INPAG that will create the underpinning framework for the development of all other Sections
- The Basis for Conclusions on the Exposure Draft, which includes:
    - considerations in developing the proposals
    - the potential effects of the proposals
- Implementation Guidance with illustrative examples, together with example financial statement formats.
- Invitation to comment with significant matters for comment (SMCs)

Submit your comments

Please submit your comments electronically by 31 March 2024:

- Online: https://www.ifr4npo.org/have-your-say
- By email: ifr4npo@cipfa.org

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