



# Technical Advisory Group Issue Paper

AGENDA ITEM: TAGED16-01  
12 December 2023 – Virtual

## Fund Accounting

Summary	The paper provides a first draft of the new Section to be included in INPAG on Fund Accounting.
Purpose/Objective of the paper	The paper explains the approach to the development of Section 36. It outlines the criteria for the existence of a fund and the characteristics of a fund with restrictions, taking account of the feedback provided by the TAG at its meeting on 7 November 2023. It proposes Authoritative Guidance that includes a decision tree to assist with the application of the guidance in this Section.
Other supporting items	TAGED15-01 Illustrative financial statements
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Actions for this meeting	<b>Advise on:</b> <ul style="list-style-type: none"><li>i. the adequacy of the definition of a fund with restrictions in Section 2;</li><li>ii. the criteria for the existence of a fund and the characteristics of a fund with restrictions;</li><li>iii. the decision tree proposed in the authoritative guidance; and</li><li>iv. the role of moral and ethical considerations in the development of the guidance.</li></ul>

# Technical Advisory Group

## Fund Accounting

### 1. Introduction

- 1.1 Exposure Draft 3 is the final planned exposure draft that will set out the proposals for the remaining INPAG sections. One of these is a new Section on Fund Accounting. The principles for the drafting of this section were shared with the TAG at its meeting on 7 November 2023.
- 1.2 Taking account of the feedback from the discussion at this meeting Section 36 has now been drafted and is included as Annex A.

### 2. Fund accounting – two-step process

- 2.1 As noted in TAGED14-01, Section 2 *Concepts and pervasive principles* shared in Exposure Draft 1 establishes the principle that the funds of an NPO shall be split between funds with restrictions and funds without restrictions. Fund accounting is one of the key concepts in developing INPAG and Section 2.
- 2.2 In TAGED15-01 it was proposed that a two-step process is adopted to identify which transactions are to be presented as part of funds with restrictions. This two-step process requires that all funds within an NPO are identified as step one. Having identified all of the funds that exist, an NPO is required to assess each fund to determine whether it is a fund that meets the criteria of a fund with restrictions or not.

#### *Proposals for the definition of a fund*

- 2.3 In step one it is proposed that for a fund to exist it must meet all of the following criteria:
  - a) it is part of an NPO's activities for which separate accounting records are kept that are independently maintained from other parts of the NPO's activities;
  - b) the separate accounting records comprise all income, expenses, assets and liabilities that relate to that part of the NPO's activities; and
  - c) it enables the NPO to track its resources.
- 2.4 As previously noted, this definition of a fund may be challenging for NPOs who have previously tracked income and expenses but have not, or do not currently have the systems capability to track assets and liabilities. However, the requirement to track

assets and liabilities might usefully serve to filter out very granular application of the guidance and thereby reduce any associated reporting burden for NPOs.

**Question 1:** Do TAG members have any comments on updated definition of a fund?

*Proposals for which funds are presented as part of funds with restrictions*

- 2.5 In the paper presented to the TAG on 7 November 2023 the TAG was generally supportive of the proposals made for step 2 of the process to identify which funds should be part of funds with restrictions.
- 2.6 There was agreement that an arrangement that includes a requirement imposed through legal or equivalent means would be part of funds with restrictions. There was also agreement that a public commitment to use resources in a specified way could also result in a fund that should be presented as part of funds with restrictions. TAG members sought clarification on the nature of a public commitment needed and the timing of the commitment to meet the intentions in the proposal. As a result the characteristic has been amended to confirm that the commitment must be externally communicated and must be made either before or at the launch of a fundraising campaign.
- 2.7 There was also a discussion about the need for a moral or ethical commitment to exist for a fund to be presented as part of funds with restrictions. The Secretariat agrees that this moral or ethical commitment underpins the intent but is concerned about its practical application. It could be argued that there is a moral and/or ethical commitment for the use of all resources provided to an NPO. On its own it might not be possible to identify which transactions should be presented as part of funds with restrictions and which not.
- 2.8 As a consequence the Secretariat proposed to not use these terms in the main guidance. The Application Guidance does refer to specific moral and/or ethical obligations arising from externally communicated public commitments that have created the valid expectations that resources will be used in specific way to develop the understanding of the nature of these types of constructive obligations.
- 2.9 As a consequence, it is proposed that a fund shall be presented as a fund with restrictions when at least one of the following criteria are met:
- a) access to the resources in a fund is restricted through legal or other means;
  - b) an NPO has made an externally communicated public commitment at or before the launch of a fund raising campaign that resources obtained through

- the campaign will be used for a specific purpose creating a valid expectation on the use of resources; and/or
- c) acceptance of any terms set by the grantor or donor that require those terms to be followed.

**Question 2:** What are TAG members' view on the use of moral and ethical considerations in the Guidance and Authoritative Guidance?

**Question 3:** Do TAG members have any further comments on the criteria for a fund to be presented as part of funds with restrictions?

- 2.10 All other funds are to be presented as part of funds without restrictions. This will include funds that governance bodies have set aside for specific purposes and have an internally designated purpose.
- 2.11 At the TAG meeting on 7<sup>th</sup> November 2023 it was proposed that funds without restrictions will also include any revaluation reserves. It was noted that there may be situations where an asset that is included in fund with restrictions is revalued. In these circumstances the amount of the revaluation will be included in a revaluation reserve as part of funds with restrictions. The text in paragraph G36.16 c) reflects this proposal.
- 2.12 As previously noted Section 2 defines funds with restrictions as follows:

*Funds that are required to be expended, invested or retained by the NPO for a specific purpose or activity as a consequence of externally imposed funding or other legal arrangements placed on the NPO by a resource provider.*

- 2.13 In the light of the proposals in Section 36, this definition needs to be reviewed to ensure that it is inclusive of all funds that might be characterised as having restrictions. In particular those funds that do not have a legal requirement to be used in a particular manner, but where those providing the resources have a valid expectation that resources will be used in a specific way. As a consequence it is proposed to slightly amend the definition as follows.

*Funds that are required to be expended, invested or retained by the NPO for a specific purpose or activity as a consequence of externally imposed legal or equivalent arrangements placed on the NPO by a resource provider, or arising from an external public commitment in relation to a specific fundraising campaign.*



**Question 4:** Do TAG members agree with the proposed consequential amendment to the definition in Section 2?

### *Disclosures*

- 2.14 As previously discussed with the TAG, Section 36 introduces the requirement to produce a movement in funds note. This is reflected in the proposed disclosure requirements.
- 2.15 These disclosures will require that the income and expenses associated with an EGA be disclosed as funds with restrictions given that EGA's are expected in most cases to meet the definition of a fund with restrictions. Such disclosures will provide transparency over EGA transactions, even though there may be no opening or closing fund balance.

**Question 5:** Do TAG members have any comments on the proposed disclosure requirements?

### **3. Authoritative Guidance**

- 3.1 The Authoritative Guidance expands on the proposals in Section 36. A decision tree has been included in the Authoritative Guidance to outline the two-step process proposed to determine whether an NPO has a fund that is to be presented as a fund with restrictions.
- 3.2 As noted above, the Application Guidance makes reference to moral and/or ethical obligations and to the expectation that EGAs will likely be presented as funds with restrictions.

**Question 6:** Do TAG members have any comments on the decision tree or any other part of the Authoritative Guidance?

### **4. Next steps**

- 4.1 The text will be finalised following feedback from the TAG. This will next be shared as part of a full draft of ED3 expected to be distributed around the middle of January 2024.



- 4.2 The basis for conclusions will be developed reflecting the TAG discussions. No Implementation Guidance is proposed, with the mandatory disclosure requirements to part of the illustrative financial statements that will be shared as part of ED3. Illustrative examples of the application of the two-step model could be linked to existing examples in Section 23. Alternatively specific examples could be developed particularly to illustrate the impact of internal decisions on the categorisation of funds.

**Question 7:** What are TAG members' views on the need for Implementation Guidance and if needed, where it should focus?

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## Annex A

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### Section 36 Fund Accounting

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#### Scope of this Section

G36.1 Fund accounting is one of the key concepts in INPAG. This section sets out the characteristics of a fund for the purposes of INPAG and how each fund is presented in the general purpose financial statements. INPAG requires that all transactions must be presented as either part of funds with restrictions or funds without restrictions.

#### Characteristics of a fund

G36.2 A pre-requisite for fund accounting is an understanding by an NPO of the different funds it holds. A fund may exist for a variety of reasons. Most commonly it will be an operating choice by an NPO about how it manages itself, a requirement as a result of jurisdictional law relating to NPOs, or a legal or equivalent requirement arising from arrangements with grantors or donors.

G36.3 For the purposes of INPAG a fund will exist where all of the following criteria are met:

- a) it is part of an NPO's activities for which separate accounting records are kept that are independently maintained from other parts of the NPO's activities;
- b) the separate accounting records comprise all income, expenses, assets and liabilities that relate to that part of the NPO's activities; and
- c) it enables the NPO to track its resources.

G36.4 As a consequence the income, expenses, assets and liabilities recorded against each fund must relate to the activities undertaken to further the specific purposes of the fund.

G36.5 An NPO that is not subject to external requirements that require separate funds and chooses not to internally designate funds will have one fund.

G36.6 Each fund must be presented as either part of funds with restrictions or funds without restrictions. An assessment must be carried at each reporting date to determine whether each individually identified fund shall be presented as part of funds with restrictions (see paragraphs G36.7-G36.13) or part of funds without restrictions (see paragraphs G36.14-G36.16).

#### Funds with restrictions

G36.7 INPAG Section 2 defines funds with restrictions as:

*Funds that are required to be expended, invested or retained by the NPO for a specific purpose or activity as a consequence of externally imposed ~~funding or other~~ legal or*



*equivalent arrangements placed on the NPO by a resource provider, or arising from an external public commitment in relation to a specific fundraising campaign.*

- G36.8 As a consequence a restriction arises where resources can only be lawfully used for a specific purpose or a grantor or donor requires that the resources it provides are applied to specific purposes, activities, assets or resources. Such requirements limit in varying levels the choices an NPO has about how to achieve its missional objectives.
- G36.9 A fund shall be presented as a fund with restrictions when at least one of the following criteria are met:
- access to the resources in a fund is restricted through legal or other means;
  - an NPO has made an externally communicated public commitment at or before the launch of a fund raising campaign that resources obtained through the campaign will be used for a specific purpose creating a valid expectation on the use of resources; and/or
  - acceptance of any terms set by the grantor or donor that require those terms to be followed.
- G36.10 It is possible that an NPO has many individual funds that have restrictions. The number of funds will be determined by the operational requirements of each NPO. Figure AG36.1 sets out the key decision points.
- G36.11 Expenses attributable to a restricted fund shall be charged to the fund even if there is an insufficient balance on that fund at the time to fund all the expenses. A restricted fund must show all of the transactions related to its specific purpose.
- G36.12 A reasonable allocation of support costs associated with managing the fund may be charged to the fund, where this is permitted under the terms of the fund.
- G36.13 When a fund that is presented as with restrictions is no longer required because the reason it was established no longer exists (eg purpose achieved), any balance on the fund shall be transferred to or from funds without restrictions and the fund closed.

### **Funds without restrictions**

- G36.14 Funds without restrictions are those funds that can be used at the discretion of the governing body of an NPO to further its missional purposes.
- G36.15 An NPO's governing body can designate funds for specific internal purposes. This can include setting aside funds for a future project or commitment, such as investment in new equipment to deliver the NPO's missional objectives. Such internal designations create funds that are to be presented as funds without restrictions as the NPO's governing body has the discretion to alter any such allocations.
- G36.16 Funds without restriction shall include:
- any fund that is not presented as a fund with restrictions;



- b) any fund that has been created by internal designation by an NPO's governance body; and
- c) all revaluation reserves except where the revaluation relates to an asset that is included in a fund with restrictions.

## Transfers between funds

G36.17 A transfer between funds with restrictions and funds without restrictions may be made for several reasons, including:

- a) to make good the shortfall on a fund with restrictions;
- b) to transfer a non-current asset purchased from a fund with restrictions that is held for a general and not a restricted purpose;
- c) where the balance on a fund with restrictions has been released by the grantor or donor and can be used for any purpose; or
- d) where the balance on a fund with restrictions can be used for an alternative purpose without legal or regulatory consequence.

G36.18 The total transfers recorded between funds with restrictions and funds without restrictions in the reporting period must always net to nil.

## Disclosures

G36.19 The notes to the financial statements must disclose:

- a) information on material individual fund balances, including the purpose of each fund;
- b) information on small funds as permitted in G36.20, including their purpose;
- c) details of the movements on funds in the reporting period, showing as a minimum total income, total expenses, total other charges and movements between funds disaggregated by each fund required in G36.19a) and G36.19b), reconciling the opening and closing fund balance;
- d) details of the reasons for any material transfers between funds with restrictions and funds without restrictions; and
- e) details of the planned use of any material designated funds (where disclosed), explaining the purpose of the designation.

G36.20 Small funds that are individually immaterial may be aggregated where they have a similar purpose. If it is not possible to aggregate small funds they shall be shown individually.

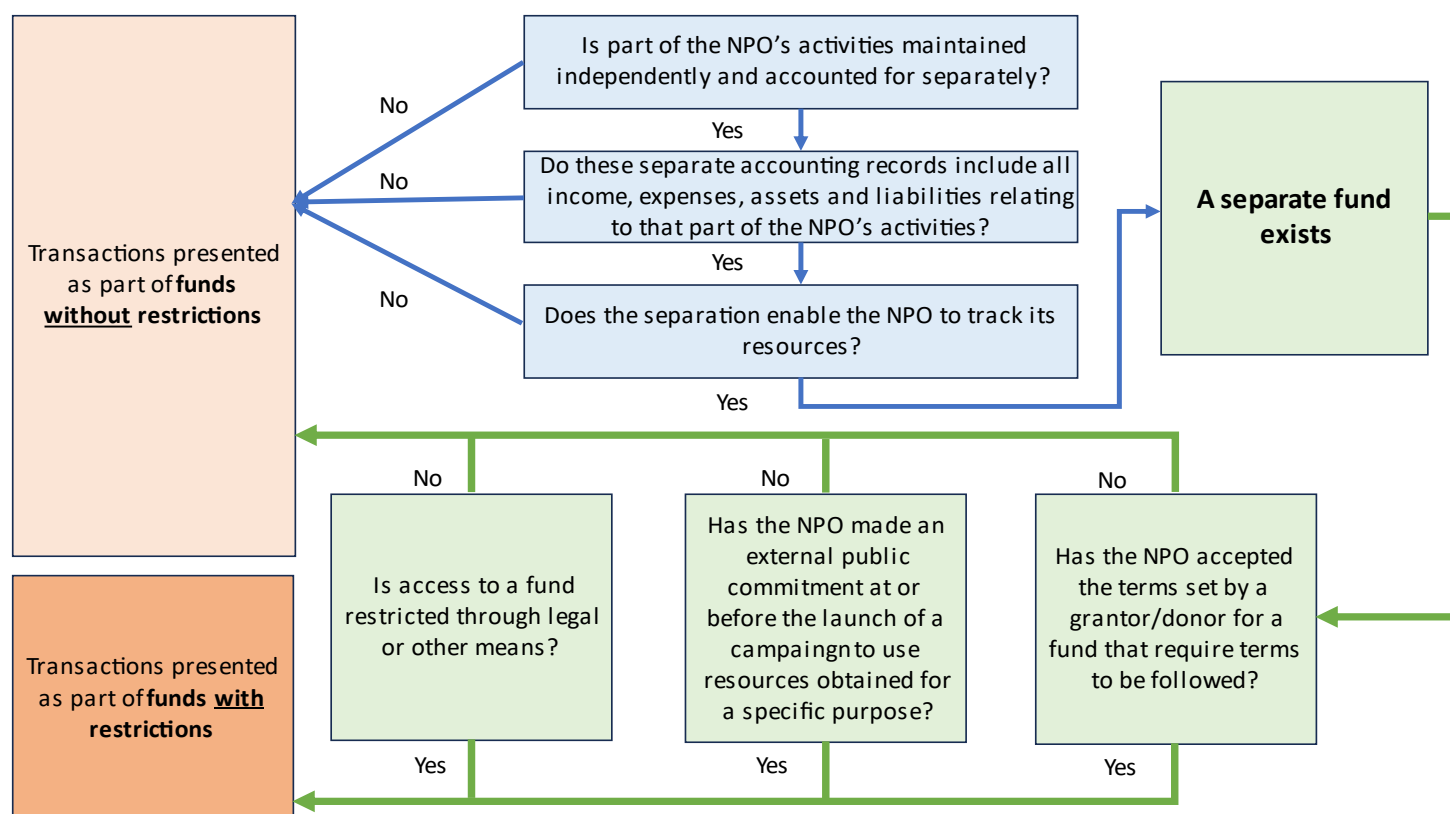
G36.21 In deciding on the most suitable form of presentation, consideration must be given to the volume and complexity of the funds held by the NPO.

## Application guidance

### Scope of the section

AG36.1 In determining what funds exist and how they should be presented NPOs must follow a two-step process. Step one is to determine which funds exist. Step two requires the assessment of each of the funds identified to determine whether it is a fund with restrictions. Fig AG36.1 sets out these steps.

Figure AG36.1: Decision tree illustrating the existence of a fund with restrictions



### Characteristics of an NPO

AG36.2 Separate accounting records may be kept within a cost centre or equivalent within an NPO's accounting system. A separate accounting entity is not required for each fund.

AG36.3 Many NPOs track income and expenses related to a grant arrangement, but not assets and liabilities. Where assets and liabilities are not separately identified the grant arrangement will not be a separate fund. As a minimum an NPO is expected to be able to identify non-current assets, work in-progress, payables, receivables and cash associated with each grant where relevant.

AG36.4 An NPO will be able to demonstrate its tracking of the use of resources in the fund through regular management reporting.

### **Funds with restrictions**

AG36.5 *Section 23 Revenue* identifies that grants and donations received by an NPO can have different types of constraint that limit how an NPO can use the resources provided. All enforceable grant arrangements (EGAs) limit the use of resources and other funding arrangements (OFAs) may include limitations that reduce an NPO's operational choices.

AG36.6 Transactions with constraints that are not EGAs can result in a separate fund that is assessed as being a funds with restrictions. The substance of a transaction rather than legal form will determine whether it is presented as with restrictions. The presentation requirement is independent of the accounting treatment which is dependent on the existence of a present obligation.

AG36.7 An EGA that meets the criteria to be a fund is expected to be presented as part of funds with restrictions because of the obligations in the grant arrangement. However, in most circumstances there will not be fund balances because of the assets and liabilities relating to each EGA that will be shown in the balance sheet. Showing the income and expenses within the movement on funds note would provide transparency over these transactions.

AG36.8 Where an NPO makes an external public commitment about the use of resources at or before fundraising commences, the campaign shall be shown as a fund with restrictions. The commitment creates a valid expectation from donors that the resources donated will be separately identifiable and will only be used for the purpose described. This places a specific moral and/or ethical obligation on the NPO to treat these resources as funds with restrictions. In some jurisdictions it may also result in a regulatory obligation. Where an external public commitment is not made as or before fundraising commences, the fundraising campaign shall be assessed in accordance with Figure AG36.1.

AG36.9 The existence of an external public commitment to use resources generated through a fundraising campaign shall not on its own create a contingent liability for the NPO. At the point of raising the funds the criteria for the creation of a contingent liability has not been met.

AG36.10 The costs that are recorded against each fund can include direct, indirect and support costs associated with the activities undertaken. The allocation of costs will be subject to the eligibility requirements of the fund. The allocation of indirect costs and support costs must follow the principles set out in Section 24 Part II *Classification of expenses*.

AG36.11 A fund may have been established that is resourced from more than one source. This could include the NPO's funds without restrictions, grant that have constraints and grants that have no constraints. Any fund that has resources that meet the criteria in

G36.9 shall be treated as a fund without restrictions, with a transfer from fund without restrictions making up the shortfall.

AG36.12 While an EGA is classified as a fund with restrictions for most EGA's there will be no opening or closing fund balance, with only the revenue earned from satisfying an EGO and the related expenses shown. Transactions associated with EGOs that are yet to be satisfied will be included within assets and liabilities. There may be circumstances where there is a difference between revenue and expenses. Where there is a realistic expectation that future income will be received to cover a shortfall or that additional expenses will be required the balance may be carried forward. Any balances shall be reviewed at the reporting date for impairment and to determine whether a transfer between funds is appropriate.

AG36.13 When a non-current asset is funded through a fundraising campaign, through a grant or donation, in deciding whether the asset is categorised as restricted or unrestricted, consideration needs to be given as to whether the terms of the gift require the tangible fixed asset acquired to be held on an on-going basis for a specific purpose; or are met once the specified asset is acquired, so allowing the use of the asset acquired on an unrestricted basis for any of the NPO's purposes.

### **Funds without restrictions**

AG36.14 In certain circumstances a donor may express a form of non-binding preference as to the use of the funds, which falls short of imposing a legal restriction or being sufficient to impose a specific moral and/or ethical obligation on the NPO. In these cases the funds shall be included as part of funds without restriction. To respect these non-binding donor wishes, the NPO's governing body may designate the funds to reflect the donors preferences.

AG36.15 An NPO's governance body may decide to designate its funds without restrictions for specific purposes. Such designation may be helpful when explaining how funds without restrictions are intended to be used. It can also be useful to explain the levels of funds without restrictions held, particularly if funds are being accumulate for a specific purpose. It can also be useful to explain the policy for holding funds without restrictions and the degree to which they are sensitive to external factors.

### **Disclosures**

AG36.16 EGAs are not likely to have opening and closing balances as per AG36.3, but the revenue earned in the period and the associated expenses will be disclosed. This will show the value of the EGOs met in the reporting period.

AG36.17 The disclosure of funds with restrictions that are not EGAs is likely to be of value to the users of an NPOs financial reports as it will enable the explanation of timing differences between the recognition of revenue and expenses. NPOs are encouraged to use these disclosures to explain an NPOs surplus or deficit for the period.