



Practitioner Advisory Group Issue Paper

AGENDA ITEM: PAGED12-01

8 February 2024 – Virtual

Fund Accounting

Summary	The paper sets out the proposals for a new Section to be included in INPAG on Fund Accounting.
Purpose/Objective of the paper	The paper explains the approach to the development of this Section. It outlines the criteria for the existence of a fund and the characteristics of a fund with restrictions. It takes account of previous feedback from the PAG and discussions with the TAG. It shows how the proposals will work through a decision tree to assist with the application of the guidance.
Other supporting items	None
Prepared by	Karen Sanderson
Actions for this meeting	Comment on: <ul style="list-style-type: none">i. the approach to defining funds and the subsequent assessment of whether restrictions exist;ii. the practical issues in applying the guidance; andiii. the usefulness of the decision tree proposed.

Practitioner Advisory Group

Fund Accounting

1. Introduction

- 1.1 Exposure Draft 3 includes a new Section on Fund Accounting. The proposals for this Section were discussed with the PAG in September and with a Focus Group held around the same time. There were a number of concerns with the proposals at the time. Respondents were concerned whether the role of regulators in determining funds with restrictions was appropriate and lead to consistent outcomes as regulation varies significantly between jurisdictions. Respondents were also concerned whether the proposals would result in a classification of transactions between those that would or wouldn't be part of funds with restrictions that would not be in line with the expectations of stakeholders. The feedback was that the substance of these types of transactions was important in classifying them, not just their legal form.
- 1.2 Subsequent to these discussions, the approach to fund accounting has been considered several times by the TAG. As a result of these discussions the approach to Section 36 evolved. The draft Section is included as Annex A.

2. Fund accounting – two-step process

- 2.1 Fund accounting is one of the key concepts in developing INPAG and was established in Section 2 as part of Exposure Draft 1. Whilst full analysis of the responses is still being carried out, a high level review has found support for the concept.
- 2.2 The key issue has been how to determine which transactions should be treated in funds with restrictions and the basis for making such a determination. In common with the approach to international financial reporting standards a principles based approach was sought. This is particularly important given the diversity of NPO activity and resulting transactions.
- 2.3 Following discussions with the TAG, the Secretariat 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 in step one that an NPO identifies all of the funds that it has. Having identified all of the funds that exist, an NPO is then required in step 2 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

2.4 In step one it is proposed that for a fund to exist, it must meet all of the following criteria:

- a) an individual stakeholder or a group of stakeholders have a reasonable expectation that resources used for a set of activities will be tracked;
- b) separate accounting records are kept for that set of activities, which are maintained separately from other parts of the NPO's activities; and
- c) the separate accounting records comprise all income, expenses, assets and liabilities that relate to that set of the NPO's activities.

2.5 There was some discussion with the TAG about whether NPOs would be able to record assets and liabilities as well as income and expenses for each fund and in particular if NPOs would have the systems capability to track assets and liabilities. However, it was noted that 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. It is proposed that feedback on this point is sought in the Exposure Draft.

Question 1: Do PAG members have any comments on this definition of a fund? What practical issues might an NPO face?

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

2.6 In the second step NPOs will then assess each of the funds. It is proposed that a fund is a fund with restrictions where:

- a) use of the resources in a fund is limited to a specific purpose or activity as a consequence of externally imposed legal or equivalent arrangements. This includes the acceptance of privately communicated terms by the grantor or donor that limit the use of resources to a specific purpose or activity; or
- b) an NPO has made an externally communicated public commitment at or before the launch of a fundraising campaign that resources obtained through the campaign will be used for a specific purpose creating a valid expectation on the use of resources.

2.7 In discussions to date there has been little disagreement where an arrangement includes a requirement imposed through legal or equivalent means that the arrangement would be shown as part of funds with restrictions. The TAG have also been of the view that where there is a public commitment to use resources in a specified way which creates an expectation on the use of the funds at the time that a grant or donation is made, this should also be presented as part of funds with restrictions.

- 2.8 There has been some discussion about the need for a moral or ethical commitment to exist for a fund to be presented as part of funds with restrictions. However, 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.
- 2.9 While it is referred to in the application guidance, it is the creation of valid expectations that resources will be used in specific way that has been adopted as a defining characteristic.
- 2.10 The criteria for a funds to have restrictions now addresses previous concerns about the role of regulators and substance over form.

Question 2: What are PAG members' view on the use 'reasonable expectations' to characterise when a fund has restrictions? What practical issues might an NPO face?

- 2.11 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.

Disclosures

- 2.12 Since the previous discussion with the PAG and the Focus Group, further consideration has been given to the disclosure requirements and the interplay with the Statement of Income and Expenses. As a result, it is now proposed to not require the presentation of funds with and without restrictions on the face of the Statement of Income and Expenses, but instead to require a movement in funds note that requires that all material funds, split between those with and without restrictions are shown (see Annex B).
- 2.13 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, e.g. funds provided in advance will be shown by a grant recipient as cash and an EGA liability.

Question 3: Do PAG members have any comments on the proposed disclosure requirements?

3. Authoritative Guidance

- 3.1 A decision tree has been included in the Authoritative Guidance to help users to determine whether an NPO has a fund that is to be presented as a fund with restrictions or not.
- 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 4: Do PAG members find the decision tree helpful? How might it be improved?

4. Next steps

- 4.1 As yet no Implementation Guidance has been developed, but the mandatory disclosure requirements will form 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 5: What are PAG members' views on the need for Implementation Guidance and if needed, where it should focus?

February 2024

Annex A

Section 36 – Fund Accounting

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) an individual stakeholder or a group of stakeholders have a reasonable expectation that resources used for a set of activities will be tracked;
- b) separate accounting records are kept for that set of activities, which are maintained separately from other parts of the NPO's activities; and
- c) the separate accounting records comprise all income, expenses, assets and liabilities that relate to that set of the NPO's activities.

G36.4 A reasonable expectation can be derived from a public commitment, legal or equivalent requirement or management requirement.

G36.5 The income, expenses, assets and liabilities recorded against each fund must relate to the activities undertaken to further the specific purposes of the fund.

G36.6 An NPO that is not subject to external requirements that require separate funds and chooses not to internally designate funds will have one fund.

G36.7 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 G36.8-G36.14) or part of funds without restrictions (see paragraphs G36.15-G36.17).

Funds with restrictions

G36.8 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.

G36.9 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.

G36.10 A fund shall be presented as a fund with restrictions when one of the following criteria are met:

- a) use of the resources in a fund is limited to a specific purpose or activity as a consequence of externally imposed legal or equivalent arrangements. This includes the acceptance of privately communicated terms by the grantor or donor that limit the use of resources to a specific purpose or activity; or
- b) an NPO has made an externally communicated public commitment at or before the launch of a fundraising campaign that resources obtained through the campaign will be used for a specific purpose or activity creating a valid expectation on the use of resources.

G36.11 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.

G36.12 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.

G36.13 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 any arrangement that has resulted in the creation of a fund.

G36.14 When a fund that is presented as with restrictions is no longer required because the reason it was established no longer exists (for example, the purpose has been achieved), any balance on the fund shall be transferred to or from funds without restrictions and the fund closed.

Funds without restrictions

G36.15 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.

- G36.16 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.
- G36.17 Funds without restriction shall include:
- a) any fund that has been created by internal designation by an NPO's governance body;
 - b) all revaluation reserves except where the revaluation relates to an asset that is included in a fund with restrictions;; and
 - c) any other fund that is not a fund in accordance with G36.17 a) or G36.17 b) or presented as a fund with restrictions.
 - d)

Transfers between funds

- G36.18 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.
- G36.19 The total transfers recorded between funds with restrictions and funds without restrictions in the reporting period must always net to nil.

Disclosures

- G36.20 The notes to the financial statements must disclose:
- a) information on individual fund balances, including the purpose of each fund;
 - b) information on small funds as permitted in G36.21, 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 G36.20a) and G36.20b), reconciling the opening and closing fund balance;
 - d) details of the reasons for any transfers between funds with restrictions and funds without restrictions; and
 - e) details of the planned use of any designated funds (where disclosed), explaining the purpose of the designation.



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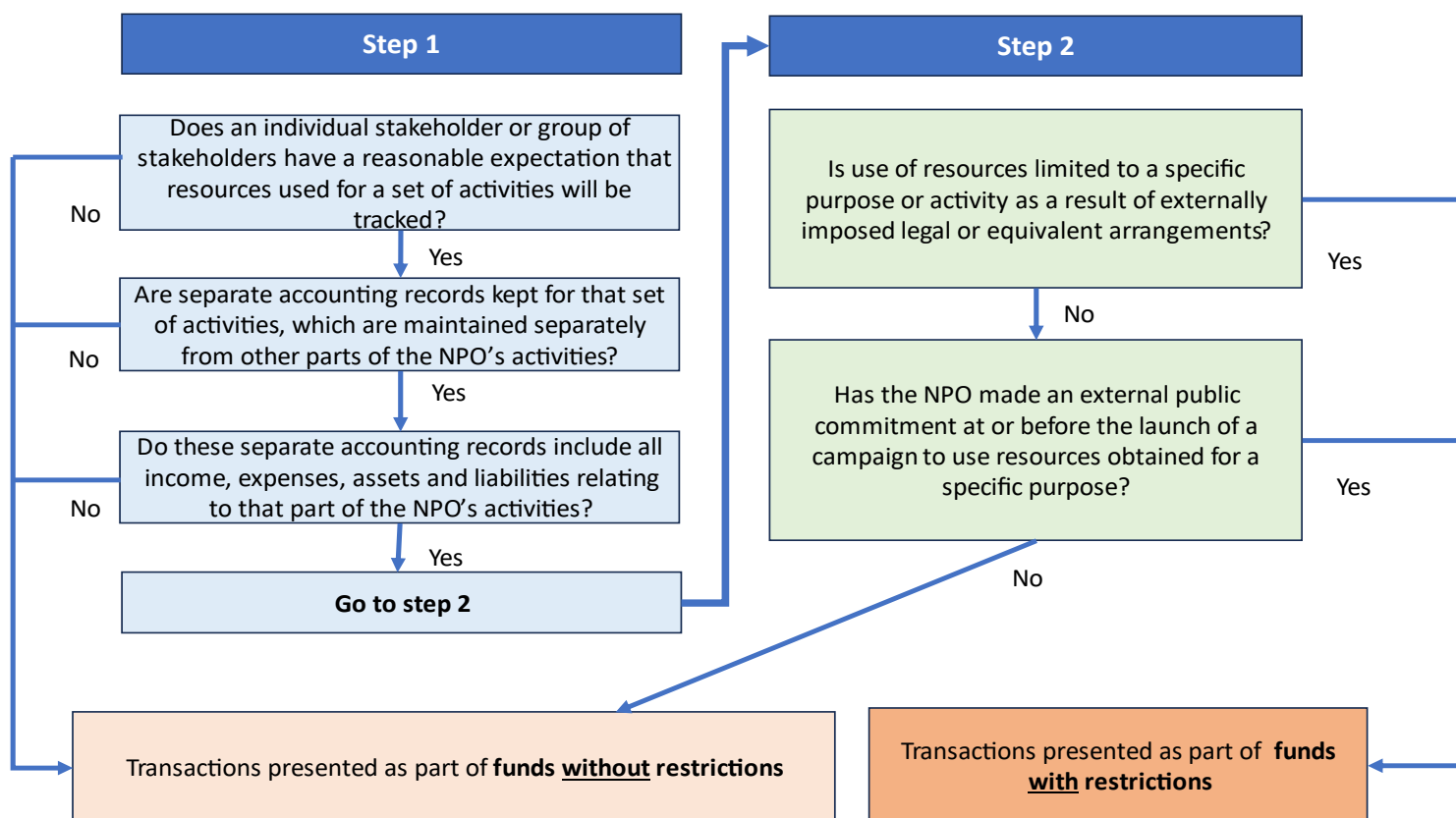
- G36.21 Small funds that are individually immaterial may be aggregated where they have a similar purpose. If it is not possible to aggregate small funds they shall be shown individually.
- G36.22 In deciding on the most suitable form of presentation, consideration must be given to the volume and complexity of the funds held by the NPO.

Application guidance: Section 36 – Fund accounting

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.

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 G36.10 and 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

G36.10 shall be treated as a fund with 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 governing 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 accumulated for a specific purpose. It can also be useful to explain the policy for holding funds without restrictions and the degree to which they act as a buffer against, or 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 go beyond the disclosures to explain an NPOs surplus or deficit for the period.



Annex B Movement in funds note

	Opening balance at 1 January 2022	Income	Expenses	Other changes	Transfers	Closing balance at 31 December 2022
	CU000s	CU000s	CU000s	CU000s	CU000s	CU000s
Funds with restrictions						
<i>Enforceable grant arrangements</i>						
Longitudinal study - Covid (3)	-	54	(80)	-	-	(26)
Covid database (5)	-	20	(25)	5	-	-
<i>Other funding arrangements</i>						
Asthma research (4)	-	100	(50)	-	-	50
Long-covid campaign (6)	-	230	-	-	-	230
Website development (8)	-	50	-	-	-	50
Bronchitis research (12)	150	-	(10)	-	-	140
Emphysema research (12)	100	-	(10)	-	-	90
Additional respite care facility	100	-	-	-	-	100
Other	30	12	(2)	-	-	40
Total funds with restrictions	380	466	(177)	5	-	674
Funds without restrictions						
<i>Designated funds</i>						
Capital improvement works	60	-	-	-	90	150
Website development	10	-	-	-	10	20
<i>General funds</i>	900	1,147	(1,458)	-	(100)	489
Total funds without restrictions	970	1,147	(1,458)	-	-	659