



Practitioner Advisory Group Issue Paper

AGENDA ITEM: PAGFG03-02

12 September 2024 – Online

Grant Expenses – Response to ED2

Summary	This paper provides a summary of the responses to the specific matters to comment (SMCs) relating to section 24 Part I <i>Grant Expenses</i> (other than the SMCs on the common grant model). It provides suggested approaches on a number of issues for the final guidance.
Purpose/Objective of the paper	The purpose of this paper is to provide analysis of the responses to the remaining SMCs on ED2 of Section 24 Part I. It seeks the views of PAG members on suggested approaches to the final guidance, building on the PAG's previous discussion of the common model. This paper focuses on grantor's rights to enforce obligations in grant agreements.
Other supporting items	PAGFG02-01
Prepared by	Sarah Sheen
Actions for this meeting	Comment on: <ul style="list-style-type: none">• the approach in Section 24 to the common grant model and the changes in terminology.• regulatory oversight and customary practices and enforcement to establish enforceable grant obligations.• the reporting of transactions across multiple reporting periods.



Practitioner Advisory Group

Grant Expenses - Response to ED2

1. Introduction

- 1.1 This paper:
- provides an overview and high level analysis of the consultation responses to the specific matters for comment (SMCs) (other than the SMCs on the common grant model) relating to Section 24, Part I *Grant Expenses* (see Annex A)
 - sets out the approaches and responses from the Secretariat on issues relating to enforceability including matters relating to regulatory oversight and customary practices. It also covers grants that cross multiple reporting periods
 - seeks PAG member's advice on issues raised in the feedback.

2. Background

- 2.1 Section 24, Part I is a new section in INPAG establishing the accounting for expenses on grants, donations and similar transfers (described in INPAG as grant expenses) by grant-providing NPOs. Section 24 Part 1 has been informed by IPSAS 48 *Transfer Expenses* taking a similar conceptual approach as adapted for NPO circumstances.
- 2.2 Section 24, Part I uses the same grant accounting model as Section 23 Part I *Revenue from grants and donations* albeit from the grant-providing NPO perspective. As a consequence, it used the concepts of enforceable grant arrangements, enforceable grant obligations and other funding arrangements included in Section 23 Part I in Exposure Draft 2.
- 2.3 A survey was also carried out that addresses some of the accounting issues raised by both Sections 23 and 24 Part I. The responses to this survey have been incorporated into the analysis of responses where relevant.
- 2.4 SMCs 5(a) and 5(b) about the grant model were considered by PAG members at their June 2024 meeting. The feedback from PAG members and from subsequent discussions with TAG members have been factored into further developments set out in section 3 of this paper below.

- 2.5 This report also focuses on grant enforceability and reflecting the substance of transactions over multiple periods. It also considers how the satisfaction of grant fulfilment rights are described.
- 2.6 The relevant extracts of current drafts of final guidance have been included in Annexes to this report. Following discussions on the structure of INPAG, (where PAG members provided feedback), the core guidance will now include application guidance, rather than application guidance being separate.

3. Common Grant Model – Changes to Section 24 Part 1 (SMC’s 5(a) and 5(b))

- 3.1 PAG considered issues emanating from the common grant model which applies to both grant revenue and grant expenses at its June 2024 meeting. The model was also considered by TAG at its July 2024 meeting. The analysis of responses for SMCs 4(a), 5(a) and 5(b) PAGFG02-01 identified challenges with the understanding of the model and its key terms for classification and recognition of both revenue from grants and donations and grant expenses. Revenue from grants and donations is covered in more detail at item PAGFG03-01 on the agenda.
- 3.2 Taking account of all of this feedback the Secretariat has reviewed the common grant model and is of the view that it is conceptually sound and consistent with the approaches in IPSAS 47 *Revenue* and IPSAS 48 *Transfer Expenses* as applied to NPO circumstances. However, the relative complexity and newness of the model means that more explanation of each of the terms is needed to help users understand it and identify the obligations within individual grant agreements, which makes clearer the unit of account.
- 3.3 The Secretariat has not therefore made substantial changes to the model in Section 24 Part 1 but as reported at agenda item PAGFG03-01 has instead sought to clarify the terminology. References to enforceable grant arrangements have been changed to enforceable grant components (EGCs) and other funding arrangements amended to other funding components (OFCs). A new overview also notes that OFCs can either be with or without restrictions in accordance with the specifications of Section 36 Fund Accounting.
- 3.4 To assist INPAG users to understand the overall approach to grant expense recognition and measurement a new overview section (see Annex B) summarises the recognition and measurement requirements for the different components of a grant agreement moving away from the term “grant arrangement” to avoid confusion with the separate units of account. This overview is supported with a flow chart which presents the different

components of a grant agreement and their accounting treatments. PAG's views are sought on the overview and whether it assists in accounts preparers understanding of the model as it applies to grant expenses.

- 3.5 At the June meeting of PAG (paper PAGFG02-01) it was also reported that one respondent did not consider that a donor's right to the recipient's future performance would give rise to an asset. This is included as a grant prepayment asset when a grant-providing NPO transfers resources prior to the grant recipient meeting its EGO. Some PAG members agreed.
- 3.6 This was discussed at the TAG meeting in July 2024. TAG members were content with the approach as it follows the rights based approach to asset recognition. They advised that the Basis for Conclusions should explain how this conceptually meets the definition of an asset in accordance with Section 2 *Concepts and Pervasive Principles*. The relevant extract is included in Annex C.

Question 1: What are PAG member's views on the overview of the common grant model as it applies to grant expenses (see Annex B)? What are PAG members' views on the terms used? Is more detail or explanation required?

4. Can regulatory oversight and customary practices create an enforceable grant arrangement?

- 4.1 For SMC5(c) seventy-seven percent agreed that regulatory oversight and customary practices can be sufficient to create an enforceable grant arrangement with seventeen percent disagreeing and six percent neither agreeing nor disagreeing. Twelve respondents did not answer this SMC.
- 4.2 Respondents that agreed with the SMC commented that the 'practices of the mechanisms of state' could be an equally effective enforceability mechanism. The feedback was that this is particularly relevant in jurisdictions where formal legal processes are less prevalent or accessible. The Secretariat would highlight that over sixty-five percent of 114 respondents to a survey question on this topic were of the view that it was very important that grants are enforceable through mechanisms other than legal rights.
- 4.3 Respondents that agreed, however, commented that:
- it was important that INPAG is clear about what equivalent means might be, noting that these might be subsets of legal and contractual rights and such means should have equal weighting to legal enforcement.

- enforceability is subject to there being a clear legal basis to believe that these mechanisms can be sufficient to create an enforceable grant arrangement
- the weight applied to these mechanisms should be based on the predictability and consistency of enforcement outcomes they provide, which might vary significantly across different contexts.

4.4 The Secretariat has now integrated the application guidance on enforceability into the Core Guidance. Paragraphs G24.13 to G24.18 set out that enforceability must:

- provide the parties to the grant agreement with the ability to enforce the enforceable grant components;
- hold the parties accountable for the satisfaction of the agreed obligations.

These paragraphs also include relevant examples to illustrate enforceability.

4.5 Paragraph G24.14 sets out that the alternative means will have an equivalent effect (and be based on the assessment of enforceability). The Secretariat has included a minor clarification indicating that the alternative mechanisms are via equivalent means having the same effect (Annex D includes the relevant extracts of Section 24 on enforceability).

4.6 Respondents that agreed considered that enforceability through equivalent means might be different in different jurisdictions. Comments included that reference to "regulatory oversight" should be removed as the regulatory bodies' role is not to enforce and they do not have the means to enforce grant agreements. While another respondent noted that in many jurisdictions, regulatory oversight frameworks establish legal requirements and standards for grant agreements.

4.7 The Secretariat agrees that the form of enforceability will differ in different jurisdictions and will depend on whether local oversight frameworks and arrangements include requirements to act in accordance with defined rules and directives. A grant-providing NPO will need to assess all the relevant factors to decide whether a grant component is enforceable. Such commentary is already included in the Implementation Guidance (see paragraph IG24.9) but the Secretariat is of the view that it may be useful to include a summary in the Core Guidance at paragraph G24.14.

4.8 A respondent that disagreed was of the view that a grant can only be performance related if it is an explicit feature of the grant conditions. A

further respondent that disagreed commented that “implied agreements” are based on assumptions and that any customary practices should be included in the grant agreement. A respondent that neither agreed nor disagreed was of the view that legal opinion should be sought on the enforceability of these mechanisms. The Secretariat remains of the view that enforceability of grant rights and commitments will not solely arise from legal systems and the grant agreement itself. Other means might include regulatory action or some customary practices which have the equivalent effect of legal mechanisms, though the grant-providing NPO will need to satisfy itself that the obligations and rights within these equivalent means are enforceable.

Question 2: What are PAG Members’ views on the Secretariat’s proposed approach to enforceability through equivalent means (see Annex D)?

5. Accounting for grants awarded for multiple reporting periods

- 5.1 Eighty-four percent of respondents agreed with SMC5(d) that the full amount of the grant should be recognised as an expense if the grant-provider has no realistic means to avoid the expense (where grants cover multiple reporting periods). Thirteen percent disagreed and three percent neither agreed nor disagreed. Ten respondents did not answer this SMC.
- 5.2 Four respondents (three that did not agree with recognising the full amount of a grant as an expense because the grant provider does not have realistic means to avoid the expense subsequently and one that did), were of the view that the grant provider would not recognise and expense as it still controlled the resources in the transaction since they have not been fully transferred to the grant recipient. A respondent also commented that grants can be cancelled for various reasons, including, for example, delays and lack of delivery.
- 5.3 Two respondents expressed views that grant expense should be recognised on a progressive basis or to coincide with the timing of the delivery of programmatic activities and expenses phased accordingly.
- 5.4 The Secretariat is of the view that matching the recognition of the expense to cashflows or activities does not accord with the concepts and pervasive principles in INPAG Section 2.
- 5.5 When the grant recipient fulfils the grant fulfilment right (enforceable grant component) the grant-providing NPO has an obligation to transfer the total

amount of resources to the grant recipient. Although the grant-providing NPO has not yet transferred resources to the grant recipient, the grant providing NPO has incurred a liability where a grant recipient has met the obligation and has no realistic means of avoiding the expense and control of the resource.

- 5.6 The Secretariat notes the comments about the potential for grants to be cancelled or where there is non-delivery. NPOs will need to consider the grant agreement. If the grant-providing NPO has a right to cancel, then it has a means to avoid future payments, and the grant expense may not need to be recognised in full. If the grant-providing NPO does not have a right to cancel and cancellation is unusual then a separate transaction will need to be recognised to reflect such events.
- 5.7 A respondent noted that this involved complexity and that while conceptually sound, is practically fraught and likely to be difficult for stakeholders to understand and administer. The Secretariat notes the potential for practical issues. Further work is planned to look at clauses in grant arrangements that could lead to greater consistency and simplification.
- 5.8 A respondent agreed except in the case where the maintenance/renewal of the grant for several years depends on an external factor that is not controlled by the parties. The Secretariat concurs that if an external factor impacts on the grant recipient's ability to meet its obligation – this will affect the recognition of the expense depending on the nature of the impact.
- 5.9 The Secretariat has augmented the drafting in this part of Section 24 for grant expenses and the Implementation Guidance and changed references from years or multi-year arrangements to reporting periods consistent with other sections of INPAG and the IFRS for SMEs Accounting Standard.

Question 3: Do PAG members have any comments on the practical issues that arise because of the specifications for recognition of grants over multiple reporting periods?

6. Extinguishing the grant fulfilment rights

- 6.1 The Secretariat is considering the drafting approach to Section 24 particularly to make the text easier to understand. This includes moving away from using the 'passive voice', which is prevalent in the text. This has caused the



Secretariat to consider how the extinguishing of grant fulfilment rights are described.

- 6.2 ED1 describes grant fulfilment rights as being “met” or “satisfied”. These terms are appropriate from the grant recipient’s perspective as they are meeting the enforceable grant obligations. However, these terms do not technically describe the event from the grant-providing NPO perspective, which considers the treatment of the grant fulfilment rights rather than the enforceable grant obligations.
- 6.3 This has been considered by the Secretariat previously. IPSAS 48 describes the derecognition of the asset when or as the transfer right is extinguished when referring to transfer expenses (the equivalent of grant expenses in IPSAS). The use of the term “extinguish(ed)” is correct but was previously considered more technically complex and challenging for translation. Section 24 therefore describes the grant fulfilment right as being ‘met’ or ‘satisfied’. Particularly in drafting to avoid the ‘passive voice’ the Secretariat is of the view that the use of ‘met and satisfied’ need considered, and at least explained. It suggests two alternatives:
- retain the current approach but include a paragraph to explain that ‘met’ or ‘satisfies’ means that the grant fulfilment right is extinguished;
 - change the description of the event to extinguishing the grant fulfilment right and provide an explanation of what this means.

Question 4: What are PAG members’ views on the current approach of grant fulfilment rights being met or should section 24 change the description of the event to extinguishing the grant fulfilment?

September 2024



Annex A Summary of Feedback Responses to SMCs for Grant Expenses

SMC 5(c) Enforceable grant arrangements are required to be enforceable through legal or equivalent means. Do you agree that regulatory oversight and customary practices can be sufficient to create an enforceable grant arrangement? If not, why not? What weight should be applied to these mechanisms?	Response	Number	% of those who responded
	Agree	27	77%
	Disagree	6	17%
	Neither agree nor disagree	2	6%
	No Response	12	-
		47	100 %

SMC 5(d) 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?	Response	Number	% of those who responded
	Agree	31	84%
	Disagree	5	13%
	Neither agree nor disagree	1	3%
	No Response	10	-
		47	100 %

SMC 5(e) Do you agree that grants for capital purposes are expensed by the grantor using the same principles as other grants? If not, why not? What would you propose instead?	Response	Number	% of those who responded
	Agree	32	97%
	Disagree	1	3%
	Neither agree nor disagree	0	-
	No Response	14	-



SMC 5(f) Do the proposals for disclosure of grant expenses, which include a sensitive information exemption, provide an appropriate level of transparency? If not, what would you propose and what is the rationale for your proposal?	Response	Number	% of those who responded
	Agree	33	94%
	Disagree	2	6%
	Neither agree nor disagree	0	-
	No Response	12	-

SMC 5(g) Do you agree that a grant-providing NPO with an OFA can only recognise an asset at the point that a grant recipient has not complied with a constraint on the use of funds provided? If not, what would you propose instead?	Response	Number	% of those who responded
	Agree	30	97%
	Disagree	1	3%
	Neither agree nor disagree	0	-
	No Response	16	-

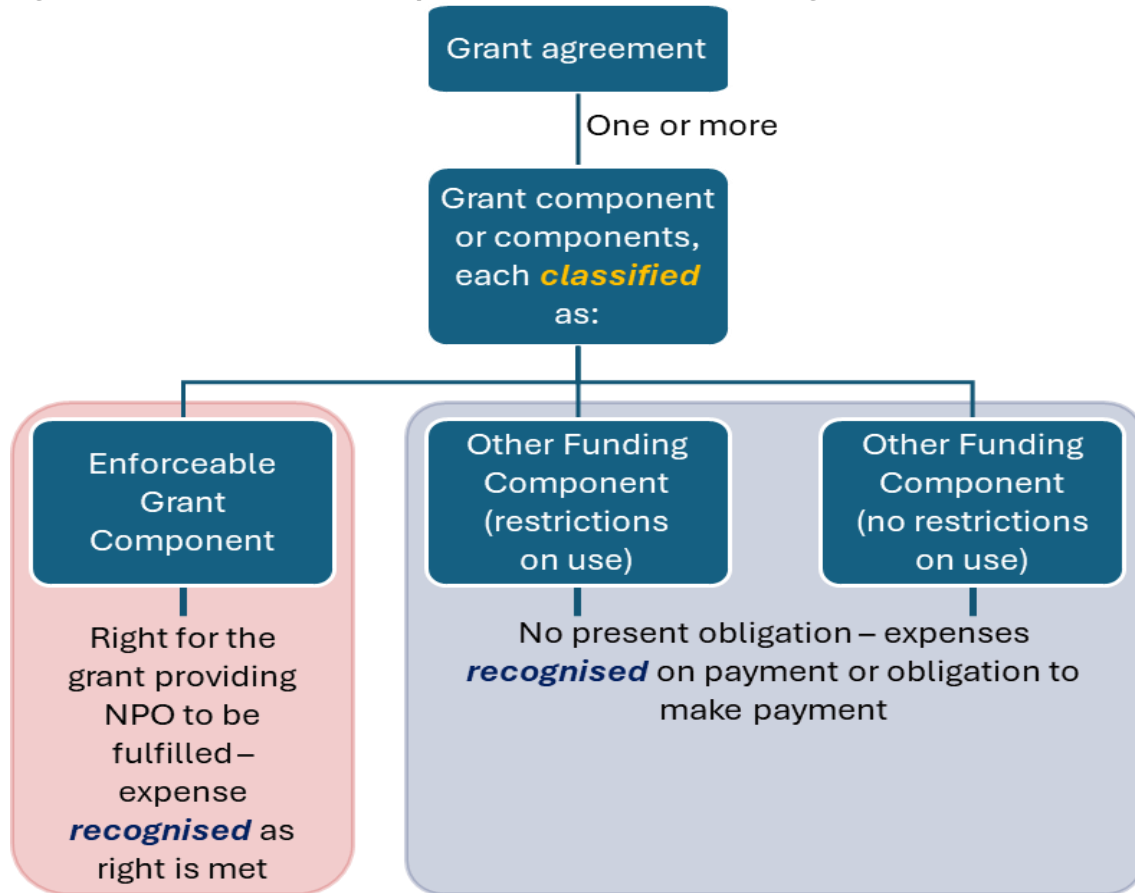
Annex B Section 24 Grant Expenses – New Overview Section

Overview of grant expense classification and recognition

- G24.1 A **grant expense** is an expense arising from a transaction in which a grant-providing NPO assists a grant recipient by transferring cash or a service, good or other asset to that grant recipient without directly receiving any cash, service, good or other asset in return.
- G24.2 A grant expense for a grant-providing NPO may arise not only from grants but also items described as donations, gifts, and similar transfers of resources.
- G24.3 A typical grant agreement (or other similar agreement for the transfer of resources) may contain one or more grant components. An NPO classifies these components as either an enforceable grant component (EGC) or an other funding component (OFC). The recognition and measurement principles for grant expenses are based on whether a transaction is from an EGC or an OFC. OFCs may include restrictions on their use, or not. Section 36 *Fund accounting* provides the definitions for when funds are subject to restrictions.
- G24.4 An EGC exists where a grant agreement contains written, oral, or similar specifications that establish rights for the grant-providing NPO and obligations for the grant recipient. A grant providing NPO recognises a grant expense when the grant recipient satisfies or meets the right (a grant fulfilment right).
- G24.5 An OFC exists for all other grant components. In an OFC a grant-providing NPO recognises expenses when it transfers resources and makes a payment or when it establishes a present obligation to make payment through legal or similar means.
- G24.6 Figure 24.1 below provides an overview of grant expense classification and recognition.



Figure 24.1: Overview Grant Expense Classification and Recognition





Annex C Section 24 – Extract of Basis for Conclusions on the Grant Prepayment Asset

BC24.51 A respondent did not support the application of the model for grant expenses, as they did not consider that a donor's right to the recipient's future performance would give rise to an asset (although the obligation to perform would be a liability for the grant recipient). Some PAG members expressed support for this view.

BC24.52 The Secretariat is of the view that in line with the approach in IPSAS 48, there is an asset. This is because the features, consistent with the definition of an asset in Section 2 *Concepts and pervasive principles* exist ie:

- The grant fulfilment right represents a resource (the right to direct how the grant recipient uses the resources);
- The EGC provides the grant-providing NPO with the control on the grant fulfilment right; and
- This control emanates from a past event (the transfer of resources in the EGC).

Annex D Section 24 – Extract on Enforceability

Enforceable grant component

- G24.9 An **enforceable grant component (EGC)** is a grant component that confers both rights and obligations, enforceable through legal or equivalent means, on both the parties to the grant commitment. This could be through a written grant agreement but could also be through an oral agreement or implied by a grant-providing NPO's or a sector's customary practices. In determining whether a grant component is enforceable, a grant-providing NPO must consider the substance rather than the legal form of the grant component. This will require the consideration of the grant providing NPO's, the grant recipient's and the sector's customary practices.
- G24.10 An EGC must specify the outcome that the grant recipient undertakes to achieve with the transferred resources, the activities that the grant recipient undertakes to carry out with the transferred resources, or the distinct services, goods and other assets the grant recipient undertakes to use, either internally or to transfer externally. Such requirements on the use of the resources create an **enforceable grant obligation (EGO)**. See paragraphs G23.48 and G23.49 for more on EGOs.
- G24.11 An **other funding component (OFC)** is a grant component that is not enforceable through legal or equivalent means and does not give both parties rights. An other funding component may be a written grant agreement, an oral agreement or implied by customary practices. An OFC also includes those situations where a grant-providing NPO transfers resources to a grant recipient without there being any agreed or implied obligation in place. An OFC may constrain the grant recipient's use of the resources, but this will not be sufficient to create an EGO. This is because an OFC does not confer both rights and obligations, enforceable through legal or equivalent means, on both the parties to the grant agreement.
- G24.12 Grant expenses may therefore arise from transactions involving:
- OFCs; and
 - EGCs.

Issues related to enforceable grant components

Enforceability in an enforceable grant component

- G24.13 To be an EGC, the interdependent rights and obligations in the grant component must be enforceable. This means that the grant-providing NPO can require the grant recipient to complete the agreed obligations or be subject to remedies for not doing so, and the grant recipient is able to require the grant-providing NPO to transfer the amount agreed. A grant component will be an EGC if there is the ability to exercise these rights, even if in practice they are never or rarely utilised.
- G24.14 Enforceability can arise from various mechanisms. A grant providing NPO should assess all the relevant factors when deciding whether a grant component is enforceable. While

these mechanisms may be through legal systems, there may also be alternative processes that are equivalent means having the same effect, depending on the parties involved in the EGC and the jurisdictions in which they are based.

- G24.15 For example, in some jurisdictions, NPOs may be subject to a form of regulatory oversight which, regardless of the legal basis of an individual agreement, requires NPOs to act in accordance with defined rules and directives or potentially face censure. This broader regulatory oversight may mean the parties to a grant agreement have an additional mechanism available to enforce the grant component through appeal to a regulator, even if the specific agreement is not legally enforceable.
- G24.16 It is also the case that in some jurisdictions, public sector entities are not permitted to contract in their own name, but alternative processes with equivalent effect to legal arrangements such as executive orders or ministerial directives are in place to ensure that agreed-upon obligations in a grant agreement are enforceable. A grant-providing NPO may not therefore be able to enter into a legally enforceable arrangement with a public sector entity that is a grant recipient, but the alternative processes will provide for enforceability of the EGC.
- G24.17 A key issue for a grant-providing NPO is whether it can consider the ability to reduce or withhold future funding from a grant recipient as an enforcement mechanism. Generally, the ability to reduce or withhold future funding will not on its own be a valid enforcement mechanism because there is no present obligation on the grant-providing NPO to provide this future funding.
- G24.18 However, if there is interdependency with other grant agreements with the grant recipient, the potential for the grant-providing NPO to reduce future funding could be a valid enforcement mechanism. For example, if the grant agreement presently entitles the grant recipient to funding in the future through another grant agreement, and the terms of this other grant agreement specifically allows for a reduction in funding if other grant agreements are breached, then the potential reduction in funding could be a valid enforcement mechanism. This will require the grant providing NPO to apply judgement based on the facts and circumstances, including any history of reducing funding where it has had the right to do so.

Customary practices

- G24.19 A further key issue is the extent to which in certain circumstances enforceability may arise from a grant-providing NPO's, a grant recipient's or a sector's customary practices.
- G24.20 Where a grant-providing NPO makes grants to a public sector body, enforceability may arise because public bodies, through long-established policies and practices, create a legitimate expectation of how they will behave. However, these legitimate expectations will usually be enforceable through legal mechanisms such as a court ruling that mean a public body will be required to act in a certain way.

G24.21 For NPOs, the customary practices may be that all parties to the agreement will abide by the obligations in the agreement. However, these expectations may not be legally enforceable, as the parties may not be subject to court rulings to uphold such expectations. Enforceability in such circumstances will be dependent on the existence of equivalent means such as an appeal to a regulator or withholding or reducing future funding through a linked EGC.

General statements of intent and oral agreements

G24.22 A general statement of intent by a grant-providing NPO that it may transfer cash or deliver goods, services or other assets in a certain way is not usually in and of itself an EGC under which both parties have rights and obligations. It may, however, give rise to a constructive obligation in accordance with paragraph G21.4 of Section 21 *Provisions and contingencies*.

G24.23 A general statement of intent differs from an oral agreement between a grant-providing NPO and grant recipient. Oral agreements will arise from serious discussions between the parties where the grant-providing NPO has made an offer to transfer cash, goods, services, or another asset to a grant recipient, who has accepted the requirement to meet an obligation. Depending on the substance of the grant commitment or agreement, an oral agreement may be sufficient to create an EGC, particularly in those jurisdictions where oral agreements can be legally binding.

IMPLEMENTATION GUIDANCE ON ENFORCEABILITY

What should an NPO consider in assessing enforceability?

IG24.7 Determining whether a grant agreement, and each party's rights and obligations in that agreement, are enforceable may be complex and require professional judgement. This assessment is integral to identifying whether the grant agreement contains components that have both enforceable rights and obligations, only enforceable rights or only enforceable obligations. In cases where an NPO does not have an EGC, it may still have an enforceable right or an enforceable obligation.

IG24.8 In developing grant agreements, the grant-providing NPO should consider its overall objectives and the risk of the grant recipient not meeting its requirements. Where the grant-providing NPO is intending to create an EGC, the grant-providing NPO should consider appropriate EGOs that it requires the grant recipient to satisfy, as these will create its grant fulfilment rights. The grant-providing NPO should consider its ability to monitor if, and when the grant recipient meets EGOs and its ability to enforce them. While enforceability may arise from various mechanisms, it is important that the mechanism(s) provide a grant-providing NPO with the ability to enforce the terms of the grant agreement and hold the parties accountable for meeting their obligations in accordance with the terms of the agreement.

IG24.9 At the inception of the grant agreement, a grant-providing NPO will need to use professional judgement and objectively assess all relevant factors and details to determine if it has enforceable rights and/or obligations (ie what is enforced), and the

implicit or explicit consequences of not satisfying those rights and/or meeting those obligations (ie how it is enforced). As noted, this will be easier if the grant-providing NPO has considered the enforceable rights and obligations and associated consequences of not meeting them in developing the grant agreement.

IG24.10 Relevant factors include, but are not limited to:

- (a) the economic substance, rather than the legal form, of the components in a grant agreement;
- (b) written, oral or implied grant agreement terms (implied grant agreement terms are those implied by an NPO's customary practices);
- (c) whether it is capable of being enforced through legal means (eg by the legal system, enforced through the courts, judicial rulings, and case law precedence), or through equivalent means (eg if a party to the grant agreement can draw on any regulatory or executive authority or directives);
- (d) consequences of not fulfilling the obligations in each component in the grant agreement;
- (e) other grant agreements with the grant recipient;
- (f) the specific jurisdiction, sector, and operating environment; and
- (g) past experience with the other parties in the grant agreement.

IG24.11 Certain mechanisms (for example, reductions of future funding, where they relate to other grant agreements already in existence between the two parties) may constitute a valid mechanism of enforcement. An NPO should consider all facts and circumstances objectively, within the context of their jurisdiction, sector, and operating environment, in making this assessment. Paragraphs G24.13–G24.23 provide guidance on assessing enforceability through legal or equivalent means and how oral agreements and customary norms and practices impact on these assessments.