



HM TREASURY

Financial Reporting Advisory Board Paper

ACCOUNTING TREATMENT OF GRANTS AND GRANT IN AID - UPDATE

Issue:	An update on discussions to change the basis on which grant in aid is accounted for in the accounts of NDPBs, ie from income to financing. Introducing a paper prepared by the Research Councils.
Impact on guidance:	Not at present; amendments to chapter 4 of the FrEM will be required in due course
UK GAAP adaptation?	N/A
IAS/IFRS compliant?	N/A
IPSAS compliant?	N/A
Impact on budgetary regime?	N/A
Recommendation:	The FRAB is asked to consider the points made below and comment as appropriate.
Timing:	Changes to the current arrangements would be introduced for 2006-07.

DETAIL

Background

1. The accounting treatment of grant in aid has been under discussion with departments for some time. FRAB (73) 05 which was discussed at the FRAB's meeting on 9 May 2005 summarised the position as at that time, and noted that a meeting between H M Treasury and Department of Trade and Industry (as sponsors of the Research Councils who have been the most vocal in their opposition to the proposal that grant in aid should be treated as financing) was planned. The meeting, held on 25 May 2005, rehearsed the arguments and concluded that the Research Councils would prepare a paper setting out their arguments for regarding grant in aid as a payment in exchange for a service.

2. The paper is attached at Annex A. This is an interim paper as a fuller paper is promised for a later FRAB meeting at which the treatment of capital contributions and capital grants proposed in the Exposure Draft

Statement of Principles for Financial Reporting –Proposed Interpretation for Public Benefit Entities will be discussed (see paragraph 5 below).

3. The Council's paper (paragraph 9) argues that grant in aid receipts should continue to be regarded as income – although it does acknowledge that grant in aid is not a completely adequate measure of "income" and that there may be a case for looking at the full budgets allocated to each Council.

4. Further arguments in support of the treatment of grant in aid in income are given in paragraph 10 of the paper – in summary:

- The ASB's *Discussion Paper on Revenue Recognition* supports a wider definition of benefits exchanged than does the ED on the Statement of Principles, in particular that revenue arises "as a result of a benefit being transferred to a customer in an exchange transaction" and that the benefit transfers "when the seller honours the promises it made under the contract".
- The activities of the Councils place them comfortably within this more extended definition. Although the relationship between NDPBs and Government is not literally contractual in a commercial sense, the paper argues that the Councils, in exchange for grant in aid, produce tangible benefits or outputs such as an increase to the fund of human knowledge, trained UK researchers in universities and institutes, development of and access to major UK science facilities and knowledge transfer from research to applications in business, industry and policy together with public engagement in science.

5. As noted above, the ASB issued an exposure draft *Statement of Principles for Financial Reporting – Proposed Interpretation for Public Benefit Entities* on 11 August 2005 that, inter alia, discusses the treatment of "contributions from controlling parties". The Treasury has sought departments' views on the recommendations in the exposure draft (in the form of a RABIG paper issued in August 2005) and will bring a summary of the points raised to the meeting of the FRAB in November 2005.

6. The Exposure Draft draws a distinction between amounts paid to a body in exchange for goods and services – which are to be treated as income – and those which give rise to an interest in the residual interest of the body. These latter amounts are to be regarded as capital contributions and credited to reserves. In this respect, the proposed approach for the treatment of grant in aid is consistent with the thinking behind the Statement of Principles.

7. To date, the responses to the RABIG letter have been from a charity which points out that the requirement to follow the Charities SORP means that it has to treat grant in aid as income, and from MOD and the Construction Industry Training Board (an NDPB) which are supportive of the approach proposed in the Statement of Principles.

Summary and recommendation

8. This paper introduces the paper prepared by DTI and the Research Councils that supports the argument that grant in aid may be given in exchange for a service and hence may be treated as income. But the main debate is likely to come as part of the discussions over the proposals in the Exposure Draft of the Statement of Principles which distinguishes between contributions from controlling parties which create a right to participate in the residual interests of an entity, and amounts received – even if from a controlling party - in exchange for goods and services, which are to be recognised as income. The FRAB is invited to make further comments.

HM Treasury

September 2005

15 SEPTEMBER 2005

Paper to FRAB: Research Council income accounting in financial accounts (dated 14 September 2005)

Introduction

1. This paper is an interim submission concerning the treatment of the income of the eight Research Councils, which are each NDPBs. It may be that the arguments may have wider validity for other NDPBs of a broadly similar type. It presents the provisional arguments for continuing with the existing income and expenditure financial accounting arrangements including their presentation in the published accounts, albeit with some possible modifications.
2. The paper is a joint submission by DTI Office of Science and Technology (OST) and the eight Research Councils, and has been discussed and agreed within the DTI's finance function.

Discussion

3. The government's £3 billion Science Budget is run by DTI Office of Science and Technology (OST). It is largely delivered by the eight Research Councils, to the extent of £2.55 billion in 2005-06. Each of the Councils is a substantial executive NDPB. Policy, as set out by the Director General of the Research Councils (DGRC), Sir Keith O'Nions, emphasises that each Council operates at arm's length from OST, on the basis of an agreed Delivery Plan.
4. Each Council is constituted by Royal Charter, under specific legislation, and OST issues an Accounts Direction in each case; there is a governing Council, and the Chief Executive is the Accounting Officer. Seven of the Councils give grants to universities for research and five of them have internal or linked research facilities, termed Institutes. Each of the seven grant awarding Councils covers an agreed area of Science. For example, the scope of the Biotechnology and Biological Sciences Research Council (BBSRC), is self-evident from its title. Consequently, each Council is an executive organisation with a considerable discretion, as distinct from a regulatory body. The Central Council for Laboratory of the Research councils (CCLRC) is a provider of and adviser on large-scale science facilities across the full science spectrum.
5. Under the government's financial regime, resource and capital budgets are allocated from the Science Budget to each Council, normally for three-year periods. Parliament through the Estimates and Appropriation Act approves the cash grant-in-aid for each Council, which is the cash expression of the use of resource and capital budgets.
6. The Science Budget income flow in the financial accounts for each Council is at present the grant-in-aid, adjusted for deferred income.
7. Under recent proposals, the Councils would be required in presenting their financial accounts to move to a form of operating cost statement, where funding from OST would be credited to a reserve (broadly similar to what applies to a central department).
8. In the context of the current debate about NDPB income accounting, the Councils consider that their arms-length status constitutes the basis of a case for retention of the existing GAAP income and expenditure financial account, with a balance sheet. They are opposed to the view that DTI OST has "control" over each of them in a detailed way. The key issue to the Councils is a clearly presented income line.

9. DTI OST agrees that each Council operates at arms-length and that OST does not seek to exert control in any close sense. Whilst recognising technical counter-arguments, it sees merit in preserving a disclosed full income flow. To DTI, whether the statement is titled an income and expenditure account or “operating cost statement” is not a critical issue as such, and there is no principled objection to the latter term. OST does however recognise that the cash grant-in-aid is not a completely adequate measure of “income”. One possibility is to look to a measure based in the full budgets allocated to each Council.
10. Provisionally, the more detailed arguments that might be advanced in support of the continued employment of disclosed income and expenditure accounting are as follows.
 - it is contended that the ASB's *Discussion Paper on Revenue Recognition* supports a wider definition of benefits exchanged than the provision of simply goods and services described in the ASB's *Public Benefit Entities* consultation paper.
 - Dealing at large with contractual relationships, the *Discussion Paper on Revenue Recognition* still defines that revenue arises “as a result of a benefit being transferred to a customer in an exchange transaction” (Summary Chapter 1) and to a benefit transferring “when the seller honours the promises it made under the contract.” (Summary Chapter 2).
 - An examination of the role of research councils places them comfortably within this more extended definition. Although the relationship between NDPBs and government may not be considered literally contractual in the commercial sense, in exchange for Grant in Aid, Research Councils, as entities at arms length from government, produce tangible benefits or outputs, namely an increase to the fund of human knowledge, trained UK researchers in universities and institutes, development of and access to major UK science facilities and knowledge transfer from research to applications in business, industry and policy together with public engagement in science.
 - The emphasis on producing tangible benefits is evidenced by the requirement under government's *Science and Innovation Investment Framework 2004-2014* published under Treasury/DTI/DfES auspices in July 2004, for each research council to provide delivery plans against its Grant in Aid funding together with metrics and output indicators.
11. The Annex summarises some recent technical developments noted for this paper.

Annex (to Research Council's paper 14 September 2005)

Some relevant recent technical developments noted for this paper

FRAB (71) 05 provides an update on the discussions with departments regarding the accounting treatment of grants and grants in aid and in particular whether grant in aid should be regarded as a "contribution from controlling parties" ie as financing, rather than, as at present, income.

These issues have been the subject of previous FRAB papers, the most recent of which was FRAB (70) 06 which was discussed at the meeting on 9 December 2004. FRAB(70) 06 was based on a discussion paper (RABIG(2005)25, 3 November 2004) which concluded that, based on Government Accounting and the resource budgeting framework, both grants and grants in aid are a cash concept and that accruing for them would be inconsistent with the resource budgeting and estimating framework.

A further consultation paper was issued (RABIG(2004)32) on 30 December 2004. It took as its starting point an acceptance that grants and grants in aid are a cash concept and, based on the conclusions in the ASB's Discussion Paper Statement of Principles for Financial Reporting: Proposed Interpretation for Public Benefit Entities, drew a distinction between cash inflows that are received in exchange for direct benefits, ie the provision of goods and services, and those that are in the nature of contributions from controlling parties.

RABIG(2004)32: in summary, it argues that grants are given in exchange for goods and services and hence should be accounted for in accordance with SSAP 4, ie either as income (or as a liability if any conditions have not been met) or, in the case of grants for capital purposes, deferred.

Grants in aid for revenue purposes are considered to be akin to contributions from controlling parties (in that they are not given in exchange for direct benefits) and should therefore be treated as financing and credited to reserves. Grants in aid for capital purposes should, as at present, be credited to a Government Grant reserve and released to income over the life of the related asset.

Reaction to these proposals was mixed, but those hostile to the suggestion have raised some fundamental issues, as follows.

(a). Commentators have argued that we are not justified in basing our approach on the ASB's Discussion Paper as it is just that, and does not form part of GAAP. The accounting treatment should be based on FRS 3 (which requires gains to be taken to income) and FRS 4 which allows a capital instrument to be treated as financing only if it does not carry with it an obligation to transfer economic benefits.

(b). Commentators have also noted that the proposition that grants in aid are not given in exchange for goods or services does not hold true in all cases. It is possible to make a case that a department gives grant in aid to an NDPB to enable the NDPB to provide an agreed range of tasks and activities in support of the department's objectives. In that sense, grant in aid is given in exchange for direct benefits (i.e. services) which the department would otherwise have to undertake itself or pay a third party to undertake. As far as the NDPB is concerned, it should be treated as income.

IMPACT ON WHOLE OF GOVERNMENT ACCOUNTS

ACCOUNTING TREATMENT OF GRANTS AND GRANT IN AID

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