



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.
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. This paper summarises the arguments relating to the proposal that non-departmental public bodies (NDPBs) should regard grant-in-aid as a “contribution from controlling parties” and show it as financing rather than, as at present, as income, ie in line with the treatment of Parliamentary supply in departmental resource accounts. It notes that there has been little progress in obtaining evidence from departments that grant-in-aid can be regarded as being given in exchange for the provision of as service (which would support the argument that it should be treated as income).

Grant-in-aid

2. Grant-in-aid is an agreed annual cash allowance which is drawn down by NDPBs as required to meet their forecast cash outgoings for the year. If the agreed amount is not fully drawn down in the year, *Government Accounting* does not allow the undrawn amount to be accrued – it is surrendered, and the NDPB needs to bid for a further allowance for the following year. Similarly, it is not possible to accrue for grant-in-aid to match expenditure incurred in the current year. This latter approach is based on the resource budgeting rules, which in turn are based on National Accounts classifications, which prevent a department from recognising the liabilities of bodies outside the resource accounting boundaries.

Proposal

3. If grant-in-aid is shown as income, the result shown in the performance statement is unrealistic to the extent that it compares cash-based receipts and accruals-based expenditure. As accounting for grant-in-aid on an accruals basis is not an option, we are proposing that grant-in-aid should be treated as a contribution from controlling parties (in line with the approach taken in the ASB's Discussion Paper *Statement of Principles for Financial Reporting: Proposed Interpretation for Public Benefit Entities*) and shown through reserves. The performance statement will thus become a statement of expenditure.

Objections

4. Objections to this proposal are:

(a) 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) that 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.

At its meeting in February 2005, the FRAB asked for further work to be done to check the validity of this argument. Department for Education and Skills has noted that the arrangements with one of its bodies (Adult Learning Institute) are akin to the purchase of a service, but there has otherwise been no response to the request to provide evidence of the argument that grant-in-aid can be given in exchange for a service.

(b) The ASB's definitions are contained in a Discussion Paper and thus do not have the appropriate status to act as the basis of our proposals. 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.

At its meeting in February 2005, the FRAB agreed that this objection did not have merit especially as its conclusions in respect of the distinction between cash inflows which relate to the provision of goods and services and those which are in the nature of contributions from controlling parties are not controversial.

(c) Showing grant-in-aid as financing means that the performance statement becomes a statement of net expenditure which is a backwards step in the light of developments towards a comprehensive

income statement and is not consistent with the accountancy principles of relevance, reliability, comparability and comprehension. It has been suggested that a net expenditure statement does not give a true and fair view and may lead to difficulties in obtaining finance from commercial lenders.

Our view is that a statement of net expenditure provides a meaningful representation of the cost to the taxpayer of the body's activities. The FRAB was not convinced by the arguments raised by commentators.

5. Most of the objections to the proposal have been received from the Research Councils. Following an exchange of correspondence, a meeting has been arranged for 25 May 2005 to enable them to put their case in more detail.

Grants.

6. The position on grants is different, in that they 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.

Summary and recommendation

8. This paper summarises the arguments supporting a proposal to treat grants in aid for revenue purposes as "contributions from controlling parties" and credited to reserves rather than being shown as income. It notes that there has been little response to a request to provide evidence that grant-in-aid could be regarded as being in exchange for a service, and that a meeting with DTI and the Research Councils has been arranged. The FRAB is invited to make further comments.

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