



# HM TREASURY

## Financial Reporting Advisory Board Paper

### EXPOSURE DRAFT ON THE STATEMENT OF PRINCIPLES FOR PUBLIC BENEFIT ENTITIES – CAPITAL CONTRIBUTIONS and CAPITAL GRANTS

<b>Issue:</b>	Consideration of the proposals in the Exposure Draft (ED) on the Statement of Principles for Public Benefit Entities regarding the accounting treatment of <b>Capital Contributions</b> and <b>Capital Grants</b> .
<b>Impact on guidance:</b>	None for the time being – see paragraph 18 of the paper.
<b>UK GAAP adaptation?</b>	The paper proposes a different treatment for capital grants from that proposed in the ED – so an adaptation of UK GAAP.
<b>IAS/IFRS compliant?</b>	Yes.
<b>IPSAS compliant?</b>	Yes.
<b>Recommendation:</b>	The FRAB is invited to consider the points made in the paper and to comment on the conclusions regarding capital grants.
<b>Timing:</b>	The proposals will affect the financial year 2006-07.

#### DETAIL

##### Background

1. The ASB issued an exposure draft (ED) on the *Statement of Principles for Public Benefit Entities* in July 2005. Its proposals in respect of **capital contributions** are contained in paragraphs 4.62 to 4.65, and in respect of **capital grants** in paragraphs 5.33 to 5.45. A further explanation is given in the Introduction, paragraphs 54-67.

##### **Capital contributions**

2. A capital contribution is one which establishes an ongoing financial interest in the residual interest (ie the difference between the total assets and total liabilities) of an entity; that is, it gives the contributor the right to participate in the residual interest of the entity either on an ongoing basis or in a winding up.

3. Capital contributions may not necessarily be received from a controlling party but, whatever the source, the ED recommends that they should be reported as increases in residual interest (ie credited to reserves) and not as gains (ie income in the income and expenditure account).

4. The ED contrasts capital contributions with “gains” which are also described as “revenue” or “income” and which result from contributions that do not give rise to a financial interest in the residual interest. Such contributions are to be credited to income.

### ***Capital grants***

5. The ED notes that a donation or grant intended to finance capital projects such as the acquisition or construction of a fixed asset does not reduce the cost of that asset nor is it a contribution to equity. The ED proposes that the donation or grant should be accounted for as revenue if all of the conditions applying to it have been satisfied; if they have not, the grant or donation should be reported as a liability until the conditions have been substantially met.

### ***Responses from commentators***

6. Departments, agencies, trading funds and NDPBs were asked to comment on the proposals in the ED. There were few responses (see Annex A), but all but one were supportive of the proposals regarding ***capital contributions***. However, all disagreed with those relating to ***capital grants***, which they felt should be credited to reserves.

7. As a general observation on the points made by commentators, it is likely that they were considering the position of grants in aid received from a controlling party, rather than those from other parties (see paragraph 8 below). Grants in aid would give rise to a financial interest in the residual interest of the entity and are thus akin to capital contributions.

8. Commentators did not generally address the specific position of a contribution from a party which does not give rise to a financial interest in the residual interest, for example, a capital contribution made by Friends of a Hospital. However, such a transaction would give rise to a donated asset, the current treatment for which (see FreM paragraph 5.2.12) is to credit a donated asset reserve.

9. The only other point was made by a charity, which argued that the ED should confirm that its proposals are not inconsistent with the SORP *Accounting and Reporting by Charities*.

### ***Grant in aid***

10. The proposals in the ED in respect of capital contributions have been used in the discussions over the treatment of grant in aid paid by departments to their NDPBs to finance cash outgoings for *revenue* purposes. The outcome of these discussions is that, unless it can be argued that the amounts paid by the department do not give rise to a financial interest in the residual interest of the NDPB (ie because they are given in exchange for the supply of goods and services), then they should be regarded as capital contributions and credited to reserves.

11. In respect of grants in aid to finance cash outgoings on *capital expenditure*, the conclusion is that these should be credited to reserves, as the transaction results in a financial interest in the residual interest of the NDPB.

## **Proposals**

12. The proposal is that only the recommendations in the ED relating to **capital contributions** should be accepted. There are reservations over the recommendations for **capital grants** and the proposal is that they should be credited to reserves and not treated as income

13. The implications are that:

- Grants in aid paid by departments to finance cash outgoings related to revenue expenditure of their NDPBs are akin to capital contributions and should be recognised through reserves in the accounts of the recipient;
- Grants and grants in aid which are given in exchange for the provision of goods and services do not give rise to a financial interest in the residual interest of the entity, and hence should be recognised as income in the accounts of the recipient;
- Where the receipt of a grant or a grant in aid given to finance the cash outgoings in respect of capital expenditure gives rise to a financial interest in the residual interest of the entity the grant or grant in aid should be recognised through reserves in the accounts of the recipient Current practice (see FreM paragraph 5.2.38(a)) is to credit such grants or grants in aid to a Government Grant Reserve which is reduced by transfers to the statement of financial performance over the useful life of the asset(s). As revaluation gains are credited to the Government Grant Reserve, it is appropriate to continue the use of this reserve, although the transfers should be made directly to the General Reserve and not to the statement of financial performance.
- Grants given by donors in respect of capital expenditure which do NOT give rise to a financial interest in the residual interest of the entity should, contrary to the recommendations in the ED be credited to a Donated Asset Reserves in line with the current practice (see FreM paragraph 5.2.12). However, as described above, the transfers from the Donated Asset Reserve should be made directly to the General Reserve and not to the statement of financial performance.

14. The FRAB is invited to comment on these conclusions. For the time being, no changes to the FreM are proposed.

## **UK GAAP compliance**

15. The proposals described above represent a departure from the recommendations in the ED and, to that extent are a departure from GAAP.

## **IAS/IFRS compliance**

16. The ED discusses the impact of the convergence programme, but does not suggest that any of its proposals in respect of capital contributions or capital grants are inconsistent with IASs and IFRSs.

### **IPSAS compliance**

17. The ED discusses the work of the International Public Sector Accounting Standards Board, but does not suggest that its proposals in respect of capital contributions or capital grants are inconsistent with IPSASs.

### **Proposed amendment to the FreM**

18. Pending comments from the FRAB, no amendments to the FreM are proposed.

### **Impact of amendment on Department Yellow**

19. No amendments to Department Yellow are proposed.

### **Summary and recommendation**

20. This paper summarises the proposals in the ED *Statement of Principles for Public Benefit Entities* in respect of **capital contributions and capital grants**.

21. It concludes that there is acceptance of the proposals in respect of capital contributions, but there is no support for those in respect of capital grants.

22. Capital grants (and grants in aid) should be credited to reserves, even if they do not give rise to a financial interest in the residual interest of the body.

23. The implications of this conclusion for grants and grants in aid are considered in paragraph 13 above.

24. The FRAB is invited to comment on this conclusion, and in particular whether they agree with the arguments regarding the treatment of capital grants.

CA TEAM

28 November 2005

**ANNEX A**

**SUMMARY OF RESPONSES**

	<b>FROM</b>	<b>COMMENT</b>
01	Dept for Constitutional Affairs	Agree proposals re contributions – I&E a/c should show cost of running business. Grants – agree HMT proposals. Not clear that showing capital grants as income would be meaningful.
02	Dept for Work and Pensions	Support for treatment of grant in aid as financing. No support for treatment of capital grants as revenue – s/be credited to reserves.
03	Dept of Health	Agree with proposals re capital contributions. Anne raises a question about the treatment of PDC. Capital grants: would prefer to credit to reserves and release to I&E over time. Not clear why assets financed by grants should be different from other assets as regards the impairment test.
04	Hydrographic Office (trading fund)	Support for treatment of grant in aid as financing. Support for disclosure of resources provided by controlling party. Support for HMT treatment of capital grants – ie no support for ED's proposals.
05	MOD	Support proposals for capital contributions. Capital grants should be credited to reserves and not to income
06	NAO	Capital contributions – broad support, but concerns over whether capital contributions automatically give right to participate in residual interest, as this exists as a result of the legislation setting up the NDPB. Capital grants - Not sure proposals are in conflict with current HMT guidance. ED refers to capital grants as those given to fund a specific asset and not capital expenditure in general. So capital grant in aid can be seen as a capital contribution and hence credited to reserves especially as it creates a financial interest in the residual interest of the body. And even if capital grant is for a specific item, NAO sees argument for treating it as contribution from owner.
07	Office of the Deputy Prime Minister	Agree GIA s/be credited to reserves. Accept operating deficits as GIA cannot be accrued. Need to distinguish between assets for admin use, and those for income generating purposes. But general agreement with HMT proposals
08	Tate Gallery (Charitable NDPB)	Tate Gallery is opposed to treatment of grant in aid as financing, citing Charities SORP.