



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 offer advice on the questions raised in paragraph 6 below.
Timing:	Although the plan is to introduce any changes for 2005-06, this is looking increasingly unlikely. 2006-07 seems more realistic.

DETAIL

Background

1. This paper 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.

2. 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.

3. 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.

4. A copy of RABIG(2004)32 is attached. 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.

5. 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. [In the light of further consideration of this approach, we are now of the view that capital grants in aid received from controlling parties should be credited to reserves with no release to income.]

6. Reaction to these proposals was mixed, but those hostile to the suggestion have raised some fundamental issues on which the FRAB's views are sought.

(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.

The conclusions in the Discussion Paper regarding contributions from controlling parties are not controversial and, notwithstanding the status of the Paper, is the FRAB content that we base our approach on its conclusions?

(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.

The nature of the financial support will be clear from the terms of the agreement to provide that support. Grant in aid is given to meet the cash requirements related to an NDPB's revenue or capital expenditure in general (albeit subject to agreed budgets). There is also a read-across to departments and Supply. It could be argued that Parliamentary Supply is given to a department in exchange for the provision of an agreed range of tasks and activities, but such Supply is credited to reserves and not to Income. Treating grant in aid as financing will mirror the treatment of Supply in resource accounts. Does the FRAB consider that it is stretching the argument to say that grants in aid are given in exchange for direct benefits?

(c) A more general point is that by showing grant in aid as financing, the performance statement becomes a statement of net expenditure. It is argued that this 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 even been suggested that a net expenditure statement does not give a true and fair view.

Under the proposals, and as with the Operating Cost Statement, the performance statement will become a statement of net expenditure. But this is a more meaningful representation of the cost to the taxpayer of the body's activities. The raison d'être of many NDPBs is not to make a "surplus" and the ability to see a trend of net expenditure is more helpful than a result based on comparing cash-based receipts with accruals-based expenditure.

Some of the comments (or one comment) was that the use of a Net Expenditure Statement may lead to difficulty with commercial lenders. However, such a Statement merely emphasises the existing risk – which is hidden in the current presentation. This could be corrected by annotation and explanation of the basis of preparation of the accounts (a number of NDPBs have a 'going concern' note in their accounts) and, even if the presentaiton stayed as it is now, we might well consider an alternative treatment and disclosure of amounts due to the parent body.

Does the FRAB agree with a move to a Net Expenditure Statement?

7. There were also a number of comments on the desirability of moving to an accruals basis of accounting for grant in aid. But as the earlier RABIG paper noted, such a move would require changes to the National Accounts framework and hence the resource budgeting arrangements.

Summary and recommendation

8. This paper provides an update on discussions with departments and others on proposals to treat grants in aid for revenue purposes as "contributions from controlling parties" and credited to reserves rather than being shown as income. The FRAB is invited to advise on issues raised by commentators (paragraph 6 above). A further paper will be put to the FRAB in due course, although whether it will prove possible to introduce changes to the current accounting treatment for 2005-06 is looking unlikely.

HM Treasury

25 JANUARY 2005