



HM Treasury

Financial Reporting Advisory Board paper Grantor accounting

Issue:	HM Treasury would like FRAB to consider various issues around grantor accounting; IFRS is silent on grantor accounting and this may be an area where additional guidance in the FReM may be helpful. There have been particular questions raised about the interaction between grantor accounting and IAS 37.
Impact on guidance:	Possibly, depending on FRAB's decision
IAS/IFRS adaptation or interpretation?	No adaptations or interpretations are being proposed.
Impact on WGA?	If additional guidance is introduced in this area, departments may change their approach to grantor accounting, which would have knock-on implications to WGA. Additional guidance should encourage consistency in grantor accounting across government.
IPSAS compliant?	HM Treasury have consulted IPSAS requirements on grantor accounting in developing this paper.
Impact on budgetary regime?	If additional guidance is introduced in this area, departments may change the pattern of expenditure recognised for grantor accounting, which may have knock-on implications to budgets.
Alignment with National Accounts (ESA10):	There is an existing misalignment between IFRS and ESA10 with respect to provisions (provisions are not recognised in national accounts).
Impact on Estimates?	If additional guidance is introduced in this area, departments may change the pattern of expenditure recognised for grantor accounting, which may have knock-on implications to Estimates.
Recommendation:	That FRAB provide advice on this issue, particularly whether additional application guidance on this area would be appropriate.
Timing:	The timing depends on the level of change (if any) to FReM guidance in this area.

DETAIL

Introduction

1. This paper seeks FRAB's views on a number of issues related to grantor accounting. This is an area where little guidance is provided in IFRS, as grant accounting guidance in IFRS is written from the grantee's perspective.
2. Issues around grantor accounting have arisen more frequently in recent months as departments have needed to determine the appropriate accounting for various COVID-19 relief schemes.
3. This paper is provided for discussion purposes, rather than aiming for FRAB to arrive at a final conclusion in this area. HM Treasury is asking for FRAB's views on whether additional application guidance would be an appropriate and sufficient avenue towards providing more clarity on grantor accounting. If FRAB would like to explore adding more guidance, HM Treasury will test this with departments and other relevant authorities and FRAB will discuss further at a future meeting.

Extant IFRS, FReM and IPSAS guidance

4. There is no specific guidance in IFRS on grantor accounting.
5. IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* provides guidance on government grants from the grantee perspective. It requires grant recipients to recognise government grants only when there is reasonable assurance that (1) the grantee will comply with any conditions, and (2) the grants will be received. Grantees should recognise grants as income. IAS 20 provides an option for grantees to defer grant income. However, FReM interprets IAS 20 to allow deferring grant income only in cases where the funder imposes specific conditions.
6. Similarly, the FReM only provides very limited guidance on grantor accounting (mainly focussing on the budget/accounts misalignment in recording capital grants). There is specific guidance in relation to EU grant expenditure. The FReM states that expenditure in relation to EU grants 'should be recognised...as closely as possible to the time of the underlying event or activity that gives rise to a liability. In practice, entities may find that claims received or authorised may form a suitable approximation for the liability, if applied consistently.'
7. IPSAS guidance also provides only limited detail on grantor accounting, but IPSASB has recently published an Exposure Draft (ED 72 *Transfer Expenses*) which proposes detailed guidance in this area. It distinguishes transfers into those with or without accompanying performance obligations and provides guidance for each. The deadline for comments was 1 November 2020.
8. IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* is mainly consistent with the equivalent standard in IFRS (IAS 37). Additionally, IPSAS 42 *Social Benefits* provides guidance for accounting for welfare programmes to individuals and households.
9. Please see Annex A for a summary of the guidance in IPSAS on this area.

Grantor accounting issues in central government

10. It is not the Board's, or HM Treasury's, role to opine on individual accounting judgements. However, we think it would provide useful context to the discussion to provide an example of one of the grantor accounting issues that arose in the context of finalising accounts for FY19/20.

11. BEIS and the devolved administrations have all faced questions about how to account for COVID-19 grant schemes for small businesses, and the retail and hospitality sector. These schemes were announced in March 2020 as part of the government's support measures in response to the pandemic, along with some guidance regarding eligibility, and some payments were made to businesses under these schemes prior to 31 March 2020. However, the majority of payments under these schemes were not made until after 1 April 2020. There was therefore a question of whether a provision should be recognised for these schemes in FY19/20.

12. IAS 37 requires that a provision be recognised when: (i) an entity has a present obligation (legal or constructive) as a result of a past event; (ii) it is probable that an outflow of economic resources will be required to settle the obligation; and (iii) a reliable estimate can be made of the obligation. For the COVID-19 schemes described above, there was a particular question regarding whether the relevant reporting entities had a *constructive obligation* with respect to these schemes as of 31 March 2020. It was generally agreed that there was no legal obligation at this date.

13. Details of the schemes varied among England, Scotland, Wales and Northern Ireland. This includes variations in the specificity and timing of announcements, eligibility guidance, and payments made to businesses. For example, there were differences in whether schemes were application-based, whether schemes were described as being effective from 1 April 2020, and whether payments were made before 31 March.

14. After lengthy discussions with the BEIS NAO audit team, the NAO technical team, and due to the lack of guidance and clarity in IFRS and the FReM, BEIS concluded in their FY19-20 ARAs that the announcements and payments under these schemes made prior to 31 March 2020 gave rise to a constructive obligation under IAS 37. Therefore, BEIS recognised a provision for these schemes, to avoid a true and fair qualification and accept a regularity qualification, whilst referring the point to the FRAB to provide clarity.

15. The Welsh Government concluded in their FY19/20 ARAs that, as of 31 March 2020, there was no legal or constructive obligation for these schemes under IAS 37 and therefore a provision should not be recognised. The Wales Audit Office disagreed with this position and therefore the Welsh Government's ARAs were qualified on a true and fair view basis. Consequently, as the Auditor General for Wales concluded there was an omission of expenditure, the accounts were also qualified on a regularity basis, as if that expenditure had been included, the budget control totals would have been breached.

16. At the time of issuing this paper, the Scottish Government FY19/20 ARAs have not yet been published. However, the Scottish Government, similarly to the Welsh Government, is of the view that, as of 31 March 2020, there was no legal or constructive obligation for these schemes under IAS 37.

17. Northern Ireland does not produce a single set of consolidated accounts, either at the government or department level. Therefore the relevant set of accounts that reflect the small business grant scheme is the accounts for Invest NI, the NDPB with responsibility for administering the scheme. Invest NI recognised an accrued liability in their FY19/20 ARAs for the small business grant scheme (also reflecting that over 25% of the scheme was paid out in FY19/20). Nothing was recognised for the retail and hospitality scheme as the scheme was not announced or launched until April 2020.

18. The discussions around these issues touched on a number of different elements of the interaction between grantor accounting and IAS 37 that will be discussed later in this paper.

19. This is just one example of an accounting issue related to grantor accounting. There have been others over the years (for example, Defra has had a number of cases with similar issues to the above). However, the increase in the value of grants as part of COVID-19 relief schemes, and the fact that many of these schemes do not involve significant conditions or continuing responsibilities for grant recipients, has highlighted the lack of guidance in this area, and the scope for varying interpretations of existing guidance.

Issues for FRAB consideration

20. There are a number of issues around grantor accounting that HM Treasury would be grateful for FRAB's feedback on:

a) Should there be general guidance on grantor accounting, for example regarding when expense or liability should be recognised?

Again, this guidance is not explicitly provided in IFRS or the FReM, and departments are expected to follow general IFRS principles when determining the appropriate accounting treatment. However, IPSASB has decided that it is useful to offer specific guidance in this area through its ED72, recognising that, in the public sector, governments are likely to transfer assets without consideration in return, and that guidance in this area would be helpful.

FRAB could consider adding guidance on areas such as:

- a) When to recognise expenses or liabilities associated with grants, potentially differentiating for conditional grants
- b) How to measure expenses or liabilities associated with grants
- c) Disclosures to provide for grants

If FRAB would like to add this guidance, we think ED72 would be a useful starting point in terms of providing principles regarding the above issues. Refer to Annex A for a summary of ED72's position. We will continue to monitor the IPSASB's deliberations in this area and the publication of any final standard.

FRAB should note that, even if guidance similar to ED72 was issued, it would not completely clarify the issues around the interaction between IAS 37 and grantor accounting (discussed below). This is because ED72 allows for the possibility that there may be commitments made around government grants that do not give rise to an enforceable obligation, so should not be accounted for using the guidance in ED72, but may give rise to a provision, so should be accounted for using IPSAS 19 (the standard on provisions similar to IAS 37).

ED72 specifically states that government announcements do not give rise to an enforceable obligation for purposes of the guidance in ED72, but should be assessed under IPSAS 19 to see if they give rise to a constructive obligation. It is this specific issue (the interaction between IAS 37 and grantor accounting) that drove many of the questions around accounting for grants in FY19/20.

FRAB should also note that there has not been significant demand from departments for general grantor guidance, indicating that they are able to use general principles in IFRS to make accounting judgements on the issues above. Again, the demand has been more concentrated on the interaction between IAS 37 and grantor accounting, particularly for multi-year grants or grant schemes that cross a financial year-end.

b) Should there be guidance on the interaction between IAS 37 and grantor accounting?

It may be helpful to provide more guidance on the interaction between IAS 37 and grantor accounting, which is relevant when there is uncertainty over the timing or amount of grant payments. This raises a question over whether provisions should be recognised in these cases.

This question is particularly relevant when there are no obligations that must be met by the grant recipient beyond initial eligibility, or when government is providing a 'unilateral offer of support'—which describes the COVID-19 grant schemes in question. Judgement is required in these cases to determine when, and whether, government commitments give rise to a constructive obligation.

There are a number of detailed questions that it might be helpful for FRAB to consider when analysing the interaction between IAS 37 and grantor accounting.

Can government announcements around grants, in isolation, give rise to constructive obligations and, therefore, provisions?

The issue whether a government announcement about grants, in isolation, can give rise to a constructive obligation and, therefore, the recognition of a provision related to that grant has been raised with the Treasury, in particular in the context of the Covid-19 measures.

An argument can be made that a government announcement about grants, in isolation, would not give rise to a constructive obligation, as government can, and does, reverse and/or update announcements and has the ability to change public fiscal commitments.

There are a number of administrative steps that may need to be undertaken between a government announcement and an outflow of economic resources. These include identification of eligible recipients; legislation; funding commitments; and other administrative processes. Government could reverse course during any of these steps. The annual cycle of budgeting and funding provision, and Parliamentary approval of spending, should also be considered in this context.

Under this logic, one could argue that any provisions around grants should only be recognised when there is a legal obligation, given the uncertainty over whether a constructive obligation can be created.

This argument is supported by reference to the guidance in IAS 37 regarding when obligations arise under new laws—IAS 37 states that obligations can only arise when enactment of a new law is virtually certain, which in many cases is the enactment itself. Given the government's ability to change its decisions, commitments around grants only give rise to obligations when those commitments are legally binding.

An alternative argument would posit that, in some cases, government announcements may be sufficiently specific and committing that they could give rise to a constructive obligation. In this instance, a blanket statement that government announcements could never give rise to a constructive obligation would not be appropriate.

This argument is supported by reference to the guidance in IAS 37 regarding constructive obligations for restructuring a business. IAS 37 states that an announcement to restructure can create a constructive obligation 'only if it is made in such a way and in sufficient detail (ie setting out the main features of the plan) that it gives rise to valid expectations...that the entity will carry out the restructuring.'

If FRAB agree with the latter argument, preparers have advised that it would be helpful to have extra guidance regarding when announcements are sufficiently specific that could give rise to a constructive obligation. We would also appreciate FRAB's input on what that guidance could entail.

Can government announcements around grants, in combination with other factors, give rise to constructive obligations and, therefore, provisions?

Even if government announcements are not sufficient in isolation to give rise to constructive obligations, there is still a question of whether they are sufficient, in combination with other factors, to give rise to constructive obligations.

This is the position set forward in BEIS' FY19/20 accounts; that it is a combination of announcements and payments that gave rise to a constructive obligation in the case of the small business, and retail and hospitality grant schemes.

IAS 37 is mainly written from the perspective of a single 'obligating event', rather than a series of events, giving rise to a constructive obligation, and therefore a provision.

This is another area where extra guidance may be helpful to clarify the role of government announcements in combination with other actions in terms of giving rise to a constructive obligation. There are frequently many 'steps' in the process of announcing and administering a grant scheme before the scheme opens for operation (eg announcements, provision of guidance, administrative preparations); it may be helpful to provide guidance on which of those 'steps' can give rise to a constructive obligation, and under which circumstances.

Can a provision for government grants be recognised before applications are received for that grant?

Again, details of the COVID-19 small business and retail/hospitality relief schemes vary between each country. However, some of these are application-based schemes. This has given rise to a question over whether it is appropriate to recognise a provision for these schemes before applications are received.

An argument can be made that, for application-based grants, a constructive obligation can never be created before an application is made. A grant recipient could not have a valid expectation that government would provide a grant if that recipient has not yet applied for the grant.

Another argument can be made that it is the act of government committing to provide grant funding to eligible entities, not the act of application by those entities, that creates a constructive obligation. It is the commitment to grant funding (with sufficient specificity) that creates a valid expectation in eligible grant recipients that government will provide funding.

Can a provision for government grants be recognised before an 'entitlement date' or 'eligibility date'?

Questions have also arisen regarding whether any provision for a government grant should be recognised before the entitlement date for that grant. That is, if a government commits itself one year to providing grants in a future year, should any liability be recognised for those grants until the date of entitlement?

This is similar to the issues above around whether government announcements, in isolation, can give rise to a constructive obligation. There is a question over whether any commitment to provide grants in a future year can give rise to a constructive obligation, because government could be argued to have the ability to change position before that future year.

Can government grants be considered executory contracts and therefore be outside the scope of IAS 37?

IAS 37 contains a scope exclusion for executory contracts (unless the contract is onerous). One might argue that this scope exclusion is not relevant for government grants, as performance is inherently one-sided on the part of the government.

However, one could also argue that nearly all grants have some level of conditionality or eligibility that must be met. An argument can be made that government grants could qualify as executory contracts in certain cases (for example, before they are paid out and before any conditions attached to the grant are met) because both the grantor and grantee have not fulfilled any obligations.

HM Treasury recommendation

21. This paper covered two overall issues related to grantor accounting:

- a) the need to provide general principles related to grantor accounting
- b) the need to provide clarifications regarding the interaction between IAS 37 and government grants.

22. Regarding the first issue, HM Treasury recommends that we continue to monitor the IPSASB project in this area, but do not actively add a project on grantor accounting in general to the work plan at this time. This is because we have not received great demand from preparers to add guidance in this area, which suggests that preparers are able to use the principles in IFRS and the FReM to determine the appropriate accounting for government grants. This includes the

accounting for things like grant-in-aid, general service funding commitments, and grants for which there are corresponding performance obligations by the grant recipient.

23. Regarding the second issue, HM Treasury recommends that we work to develop application guidance to provide more clarity on the interaction between IAS 37 and government grants, particularly for 'unilateral' grants where grant recipients do not have continuing responsibilities beyond meeting initial eligibility criteria. This is an area where there has been demand for increased and clarified guidance, particularly in light of the COVID-19 response.

24. In particular, we would like to develop application guidance regarding factors to consider when determining whether government announcements, and other actions around grants are sufficiently committing as to give rise to a constructive obligation. This could include considering the level of specificity necessary in communications around government grants to give rise to a constructive obligation, and the interaction between elements like grant applications, grant conditions and entitlement dates and the timing of any provision recognition.

25. This application guidance would not represent an adaptation or interpretation of IAS 37; rather, it would seek to clarify the application of IAS 37 in the central government context.

Q1. Does FRAB have feedback on the discussion questions raised earlier in this paper?

Q2. Does FRAB agree that HM Treasury should continue to monitor the IPSASB grantor accounting project, but that HM Treasury should not add a general grantor accounting project to its own work plan at this time?

Q3. Does FRAB agree that HM Treasury should work to develop application guidance on the interaction between IAS 37 and government grants?

Annex A: Relevant IPSAS guidance

ED 72 Transfer Expenses

A1. ED72 provides guidance for transfer expenses. It defines a transfer expense as 'an expense arising from a transaction, other than taxes, in which an entity provides a good, service, or other asset to another entity (which may be an individual) without directly receiving any good, service or other asset in return.

A2. ED72 contains different recognition and measurement guidance for transfer expenses with, and without, performance obligations. In this context, performance obligations are binding promises made by the transfer recipient to deliver goods or services back to third parties.

A3. For transfers with performance obligations, the transfer provider should recognise an asset for the right to have the transfer recipient provide goods or services to third parties. The transfer provider should subsequently recognise expenditure as the performance obligation is met by the transfer recipient.

A4. For transfers without performance obligations, the transfer provider should recognise expenditure at the earlier of the point at which the transfer provider has a *present obligation* to provide resources, or the point at which the transfer provider has lost control of these resources.

A5. In this context, present obligations arise from binding arrangements between the transfer provider and transfer recipient. A binding arrangement is an arrangement that confers enforceable rights and obligations to the transfer provider and transfer recipient.

A6. The point at which a transfer provider has a present obligation will depend on the terms of the binding arrangement and other circumstances. Whether or not a present obligation exists will not always be obvious and professional judgement will need to be applied; details of this professional judgement are part of the disclosure requirements in ED72.

A7. As discussed earlier in the paper, ED72 specifically states that a statement of intent or public announcement by a transfer provider does not give rise to a binding arrangement, and therefore cannot give rise to a present obligation. However, ED72 instructs transfer providers to consider whether the announcement gives rise to a constructive obligation in accordance with IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*.

IPSAS 19 Provisions, Contingent Liabilities and Contingent Assets

A7. The requirements of IPSAS 19 are drawn primarily from those of IAS 37. There are some changes made to the guidance to make it more applicable to the public sector. Most significantly, the scope of IPSAS 19 clarifies that it does not apply to provisions and contingent liabilities arising from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods and services provided directly in return from the recipients of those benefits.

A8. There are other terminology changes to make the guidance in IAS 37 more applicable to the public sector.

IPSAS 42 Social Benefits

A8. IPSAS 42 provides accounting guidance for social benefits. It defines social benefits as cash transfers paid to specific individuals and/or households to mitigate the effect of social risk. Social risks are events or circumstances that relate to the characteristics of individuals or households (eg age, health, poverty), and may adversely affect the welfare of those individual households.

A9. Specific examples include state retirement benefits, disability benefits, income support and unemployment benefits.

A10. The general approach in IPSAS 42 is to recognise a liability for a social benefit when the eligibility criteria to receive the next social benefit payment have been satisfied.