HM Treasury

Grantor Accounting:

Exposure draft

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Background

1.1 Many entities in central government provide grant funding. Grants may be given to other entities within the public sector, entities outside of the public sector or to individuals. According to the 2018-19 WGA, grant and subsidy expenditure amounted to £58.8bn after intra-government eliminations, making this a significant expenditure stream for the UK government.

1.2 International Financial Reporting Standards (IFRS) do not specifically address the issue of accounting for grants from the grantor perspective (i.e. by the issuer of the grant). The recognition of liabilities in respect of grant funding is usually accounted for under IAS 37 and the IFRS conceptual framework.

1.3 It should be noted that grantors have been accounting for grant liabilities under IFRS since its adoption in the public sector. In publishing this guidance HM Treasury is not developing an accounting policy or implying that there is not an appropriate accounting standard to account for grant liabilities. Rather this guidance sets out how to apply the requirements in IAS 37 in respect of constructive obligations to government grants from the perspective of the grantor.

1.4 Note that this guidance does not apply to Grant-in-Aid (GiA) as the FReM already includes specific guidance and requirements regarding how to account for GiA in central government accounts. For similar reasons, this guidance does not apply to social security and benefit expenditure as the accounting has previously been agreed by all stakeholders.

1.5 Provisions may be legal or constructive obligations. Constructive obligations may require accounts preparers to exercise more professional judgement in determining whether a liability exists at the reporting date.

1.6 IAS 37 defines a constructive obligation as 'an obligation deriving from an entity's actions where:

- by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
- as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.'

Do general public statements or policy statements about future intentions result in liabilities?

2.1 Grantors in government may make general public statements or policy statements about their future intentions. Judgements may need to be made regarding whether these statements, in isolation, could result in constructive obligations and therefore liabilities.

2.2 The issue of public statements and whether they, in isolation, can be constructive obligations is discussed in IAS 37, the Charities SORP (FRS 102) [hereby referred to as the Charities SORP] and the International Public Sector Accounting Standards Board (IPSASB) Exposure Draft on Transfer Expenses (ED 72).

2.3 For grant funding, an announcement of a grant funding scheme in isolation may not necessarily lead to a constructive obligation. IAS 37 paragraph 20 provides the following guidance:

> 'An obligation always involves another party to whom the obligation is owed. **It is not necessary, however, to know the identity of the party to whom the obligation is owed—indeed the obligation may be to the public at large**. Because an obligation always involves a commitment to another party, it follows that **a management or board decision does not give rise to a constructive obligation at the end of the reporting period unless the decision has been communicated before the end of the reporting period to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities**.'

2.4 IAS 37 states that a constructive obligation can exist with the public at large. However, the Standard also notes that the decision to provide grant funding needs to be communicated in a sufficiently specific manner such that the grantor has created a valid expectation it will discharge its responsibilities.

2.5 Applying this principle in government can be difficult. Announcements of varying size, duration and specificity are made by government entities on a regular basis. It's communicating '**before the end of the reporting period to those affected**' in a '**sufficiently specific manner**' which are key.

2.6 In many cases public statements made by grantors are not, in isolation, sufficiently specific that a valid expectation is created on the part of other parties that it will discharge those responsibilities. The grantor may:

- have discretion over eligibility criteria.
- include performance conditions with the grants.
- have discretion to withdraw the funding commitment at any time.

2.7 Generally speaking, public announcements, in isolation, are unlikely to be sufficiently specific to create a valid expectation and therefore a liability. However, this is dependent on the nature of the announcement, the details provided and whether the grantor has undertaken any further actions or administrative processes that do create a valid expectation by those affected, and therefore a liability may need to be recognised.

Grants with no performance conditions

3.1 Grants provided by government may have no specific performance conditions. If there are no conditions attached to the grant which allow the entity to avoid making future payments it is possible the full funding obligation will need to be recognised as a liability.

Grants with no performance conditions which are unilateral offers of support

3.2 Some grants provided by government entities amount to unilateral offers of support, have no performance conditions but do have eligibility criteria. For example, some unilateral offers of support provided by grantors in government may be offered only to specific parts of the economy or certain groups in society.

3.3 When statements are made regarding offers of unilateral support pre year-end, grantors will need to consider whether they have created a constructive obligation and a liability needs to be recognised. Applying IAS 37 para 20, entities will need to consider whether the public statement is communicated in a **sufficiently specific manner** to raise a **valid expectation** the grantor has no option but to make the payments.

Timing considerations around eligibility

3.4 Consideration needs to be given to the effect that eligibility criteria may have on the timing of the recognition a liability, including considering the point at which valid expectations of entitlement may arise for a grantee. Where entitlement clearly does not arise until after the financial year end, this may indicate the liability should arise in the subsequent reporting period. Where eligibility could arise before the financial year end, consideration also needs to be given to the point at which the prospective grantee could have a valid expectation of entitlement to the grant.

Multi-year grants

3.5 It is common for grantors to design grant funding schemes lasting more than one financial year. For example, a grant scheme may award in 2020-21 grants for financial years 2020-21 to 2023-24 of £10k in each financial year. In these cases, the grantor may have specifically communicated to the grantee the award of the grant over a few financial years. When applying the requirements of IAS 37, it may appear as though the grantor has created a liability of £30k.

3.6 However, the award of funding in future years may still be at the discretion of the grantor. Many grants awarded by government entities are specifically linked to receipt of Grant-In-Aid funding. It may by the case that the terms and conditions of the grant award specify that, unless enough Grant-in-Aid is received, the grantor has the discretion to terminate the grant award. Such terms included in grant agreements could impact the recognition of the provisions for multi-year grant awards.

Administrative processes

3.7 Administrative steps by the grantee to claim grant funding may not necessarily prevent recognition of a liability where they are entitled. A grantee may be fully entitled to a grant pre year-end and need only provide some personal details like their bank account details or confirm basic eligibility criteria to receive the grant payment. The grantee may be entitled to the grant pre year-end, but provide the necessary details post year-end. Such administrative processes may not necessarily preclude recognition of a liability if the grantee is always entitled to the funding and the grantor cannot withdraw funding to eligible groups. The application process may merely impact the timing of when the grant is paid to the recipient.

3.8 The key consideration is whether the grantor has created a **valid expectation before the reporting date** that it will provide grantees with grant funding, such that the grantor will not be able to avoid discharging its responsibilities.

Grants with no performance conditions but the grantor has discretion regarding who receives the funding

3.9 In some cases, grant schemes with no performance conditions require grantees to bid for funding from the grantor and the grantee is only entitled to grant funding on successful application (i.e. the grantee is awarded a grant rather than being entitled by meeting eligibility criteria or being a certain organisation).

3.10 There may be situations where a grant funding scheme has been communicated, but the grantor can reject some or all applications as it is within the grantor's discretion to do so. In these situations, the application process may affect the grantee's entitlement to the grant rather than just the timing of grant payments to the grantee, therefore affecting the recognition of a liability.

3.11 To illustrate this point, consider the following scenario (Scenario A):

- A new grant scheme has been announced with a funding pot of £Xm.
- Grantees must fill out an application setting out how they will spend the grant and demonstrate they can provide the service.
- If a grantee is successful in their bid, the grantor will communicate to the grantee they are successful.

3.12 In Scenario A the grantor has discretion over who will receive the funding. Even if all bidders could demonstrate they could provide the service, they may still not be awarded the funding. The grantor could withdraw the funding round altogether and defer to a later period.

3.13 In Scenario A the grantor, in inviting and receiving bids from grantees for the funding, is unlikely to have created an obligation. The obligating event may instead be the point where the grantor communicates to the grantee that their application has been successful. Linking back to the IAS 37 requirements, it is where the grantor has created a '**valid expectation**' that it '**will discharge its responsibilities**'.

Grants with performance conditions

4.1 In some ways, determining whether an obligation exists for grants with performance obligations is easier than those without performance obligations.

4.2 Some grants require an entity to fulfil specific performance obligations or provide certain goods or services before the grantee is entitled to the grant funding. Examples provided in the Charities SORP include payments being conditional on the number of meals provided or the usage or opening hours of a facility (Charities SORP para 7.26).

4.3 Where performance conditions exist, liabilities may need to be recognised to the extent that the performance conditions associated with the grant have been fulfilled by the grantee.

4.4 Alternatively, it may be the case that the grantee has not fulfilled performance obligations associated with the grant. This may mean there is no obligation on the grantor at the reporting date, so no liability is recognised on-balance sheet for these grants.

4.5 ED 72 has a similar requirement for recognising grant expenditure where there are performance conditions attached to the grant:

> A transfer provider shall recognize an expense when (or as) the transfer recipient satisfies a performance obligation by transferring a promised good or service (i.e., an asset) to a third-party beneficiary. An asset is transferred when (or as) the third-party beneficiary obtains control of that asset. A transfer provider may determine the point at which the third-party beneficiary obtains control of the asset by reference to the transfer recipient losing control of that asset. (ED 72 para 33)

4.6 Therefore, when determining whether a liability exists from grant schemes, entities should review whether there are any performance conditions which need to be fulfilled by the grantee.

Reliably measuring a liability

4.7 In addition to determining whether an obligation exists, the entity will need to determine whether a reliable estimate can be made of the liability (IAS 37 para 14(c)). Though the term 'reliable' may be subjective, IAS 37 makes it clear that instances where a reliable estimate cannot be made are expected to be extremely rare:

> The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which by their nature are more uncertain than most other items in the statement of financial position. **Except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognising a provision** (IAS 37 para 25).
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> In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognised. That liability is disclosed as a contingent liability (see paragraph 86) (IAS 37 para 26).

4.8 An estimate being materially uncertain may not preclude it from being a reliable estimate. IAS 1 para 125 requires entities to disclose information around assumptions and other sources of estimation uncertainty that have a significant risk of resulting in material adjustments to assets and liabilities within the next financial year.

4.9 Applying to grantor accounting, if it has been determined that a constructive obligation exists, instances of an entity not being able to reliably estimate the value of the liability are expected to be extremely rare.