HM Treasury

IAS 37 and Grantor Accounting:

Application Guidance

July 2023

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.

1.2 International Financial Reporting Standards (IFRS) do not specifically address the issue of accounting for grants from the grantor's perspective (i.e. by the issuer of the grant). This application guidance focusses specifically on the application of IAS 37 to grantor accounting[1].

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 new accounting standard to account for grant liabilities. Rather, this publication provides guidance on how to apply the requirements in IAS 37 to grant obligations 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.

Applying IAS 37

2.1 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.

2.2 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.'

IAS 37 Scope Exclusions

2.3 Before considering the detailed requirements of IAS 37 grantors should consider whether the potential obligation falls within the scope of the Standard. Scope exclusions are listed in IAS 37 paragraphs 1 – 5. In particular, entities should carefully consider whether the following scope exclusions are relevant:

[1] Aside from the accounting, accounts preparers are reminded of the Contingent Liability Approval Framework (CLAF), which provides further guidance on liabilities in central government and the HM Treasury and Parliamentary approval processes which must be complied with by those in scope of the CLAF.

- Whether the potential transaction is an executory contract, which is defined in IAS 37 para 3 as '*contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.*' Though please note that if executory contracts are onerous, the accounting requirements of onerous contracts in IAS 37 may be applicable.
- Whether the potential transaction is a financial instrument and should be accounted for under IFRS 9.
- Whether there is a contract that transfers significant insurance risk, in which case IFRS 4 will be the relevant standard.

What is a present obligation resulting from a past event?

2.4 For a provision to exist there needs to be a **present obligation** as a result of **past events**. However, one may ask what this means in the context of a government entity. The next two sections explain this further.

Past event

2.5 IAS 37 para 17 states that 'a past event that leads to a present obligation is called an obligating event'. IAS 37 defines an obligating event as 'an event that creates a legal or constructive obligation that results in an entity **having no realistic alternative to settling that obligation**.'

2.6 The part in bold is key throughout this guidance. When entities make public statements and undertake actions, accounts preparers need to judge whether an obligation has been created which will have to be settled and cannot be reneged upon.

2.7 Generally, a public statement, in isolation, would not be an obligating event. However, other actions taken by the government in conjunction with the public statement may result in an obligating event if, when taken as a whole, the government has no realistic alternative but to settle the obligation- this is explained further below.

Present Obligation

2.8 If there is an obligating event, entities need to determine whether the obligation is a present obligation.

2.9 IAS 37 para 15 notes 'in rare cases it is not clear whether there is a present obligation'. The public sector context may give rise to more instances of such ambiguity than is normal in the private sector.

2.10 In assessing whether a present obligation exists, entities may wish to refer to the Conceptual Framework. Para 4.43 of the Conceptual Framework states the following:

A present obligation exists as a result of past events only if:

(a) the entity has already obtained economic benefits or taken an action; and

(b) as a consequence, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer.

2.11 Based on the guidance from the Conceptual Framework, a present obligation can exist from actions taken by government where they may result in government having to make payments it would not have otherwise made had the government actions not been taken.

2.12 Of course, professional judgement must be exercised when determining whether actions taken by government have resulted in a present obligation to make payments at a future date.

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

2.13 Government may make general public statements or policy statements about future intentions to award grants. Judgements will need to be made regarding whether these statements, in isolation, could result in constructive obligations and therefore liabilities.

2.14 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) Standard on Transfer Expenses (**IPSAS 48**)[2].

2.15 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.**'

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

2.17 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.

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[2] All judgements made on grant liability recognition must comply with your financial reporting framework. The Charities SORP may be part of your financial reporting framework.. Reference has been made to Charities SORP and IPSAS 48 as they provide indicative guidance on grantor accounting accounts preparers may find useful.

2.18 Considering the definitions of a present obligation and past event above, a government announcement is an 'action', but may not be an obligating event. As a result of the action government **may** have to make payments in the future but it may also be the case that government can avoid making the payments and fulfilling the obligation as government is in a unique position to reverse or amend announcements on the scope of a policy or even whether the policy will go ahead at all. Grantors therefore need to ask themselves at what point does a government action or actions translate into an obligating event, whereby a valid expectation is created in other parties that the obligation will be settled?

2.19 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 the grantor 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.

2.20 Whether a liability exists 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.

2.21 Additionally, in government, policy announcements may require legislation subject to the will of Parliament in order to be implemented. In general entities should avoid pre-empting the will of Parliament in reaching conclusions on whether a present obligation exists.

Grants with no performance conditions

2.22 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

2.23 Some grants provided by government entities amount to unilateral offers of support[3], 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.

2.24 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,

[3] The term '**unilateral offer of support**' is an offer by government to make payments to parties (citizens and businesses) after the occurrence of a specified act, scenario or crisis. These offers are one-sided (non-exchange), and the grantor does not require anything in return; there is an obligation on the grantor to provide the support, but no obligation on the grantee to do anything in return.

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

2.25 Consideration needs to be given to the effect that eligibility criteria may have on the timing of the recognition of a liability, including considering the point at which valid expectations of entitlement may arise for a grantee. Where eligibility and 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.

2.26 Some grant schemes may result in a timing difference between the eligibility of a grant and entitlement to it. For example, assessment of eligibility to a payment may be made by reference to a state of affairs pre year-end but entitlement to payment may be defined with reference to a date post year-end. In these circumstances, entities should consider whether the date of entitlement to receive payment is relevant to the timing of the obligating event or merely impacts the timing of when the grantor has to make the payment[4]. This is a matter of judgement and depends on the individual circumstances surrounding the eligibility and entitlement requirements and dates.

Example

An entity has announced a unilateral offer of support to businesses whose income is below a certain threshold. Eligibility for the grant is assessed based on the annual income of the business at 1 March 202X. Eligible businesses are entitled to payment from 1 April 202X.

In this scenario the entitlement to payment on 1 April 202X would appear to mainly affect the timing of the payment. Eligibility is assessed at 1 March 202X, indicating the obligating event occurred before the year end, and a liability should be recognised.

This example is illustrative and, of course, depends on other information surrounding the grant scheme. But the key point is that accounts preparers should consider whether entitlement dates affect the date of the obligating event or whether they merely affect the timing of the payment and the obligating event is an earlier date.

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[4] Where a grant scheme has been announced close to the year end and a liability may need to be recognised, please contact your HM Treasury spending team to discuss the budgeting impact of the liability.

Administrative processes

2.27 Administrative steps for 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 (e.g. their age, level of savings, level of other income) 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 do not 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.

2.28 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

2.29 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).

2.30 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 will 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.

2.31 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.

2.32 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.

2.33 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 is likely 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

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

2.35 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). In central government, multi-year grants may include conditions relating to the availability of future funding, which may prohibit the recognition of an on-balance sheet liability (these may be commitments instead).

2.36 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.

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

2.38 IPSAS 48 has a similar requirement for recognising a grant funding liability and corresponding grant expenditure where there are performance conditions attached to the grant:

> '23. When (or as) a transfer recipient satisfies its obligations in the binding arrangement prior to the entity transferring resources, the arrangement gives rise to a transfer obligation for the entity…
>
> 24. For transfer expenses with binding arrangements, an entity shall recognize expenses…when a transfer obligation is recognized.'

2.39 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

2.40 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).

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).

2.41 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.

2.42 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.