

7 December 2009

**GOVERNMENT FINANCIAL REPORTING  
MANUAL (FReM) EXPOSURE DRAFT No:**

**(09)08**

EXPOSURE DRAFT OF PROPOSED

**AMENDMENTS TO THE FReM**

**Accounting for Capital Government Grants and  
Similar Financing from Non-Government  
Sources**

Comments to be received by 8th February 2010



HM TREASURY

**ASSURANCE & FINANCIAL REPORTING POLICY TEAM  
HM TREASURY**

This exposure draft of proposed amendments to the Government Financial Reporting Manual (FReM) is published by HM Treasury for comment only. The proposals may be modified in the light of comments received in this consultation process before being presented to the Financial Reporting Advisory Board for its approval. Final proposals approved by the Financial Reporting Advisory Board will be published as amendments to the FReM from the proposed effective date.

Comments on this exposure draft should be submitted in writing so as to be received by 8th **February 2010**. Respondents are asked to send their comments electronically to [FReM.consultation@hm-treasury.gov.uk](mailto:FReM.consultation@hm-treasury.gov.uk).

All responses will be published on the FReM website unless the respondent requests confidentiality.



**HM TREASURY**

## CONTENTS

*pages*

### **PROPOSED AMENDMENTS TO THE GOVERNMENT FINANCIAL REPORTING MANUAL (FReM)**

**Introduction and Invitation to Comment** 4

**Proposed Amendment to Government Financial Reporting Manual  
Chapter 5, Form and Content of the Annual Reports and Accounts  
and Chapter 6, Tangible Non-Current Assets** 8

# **Proposed amendments to the FReM**

## **Introduction**

---

Assurance & Financial Reporting Policy team, HM Treasury, has published this exposure draft of proposed amendments to the Government Financial Reporting Manual (FReM) as part of its ongoing work in ensuring that the Manual reflects the latest developments in government financial reporting.

## **Structure of exposure draft**

---

The exposure draft includes a section for each FReM chapter for which an amendment is proposed. Each section includes:

- (a) An explanation of why the amendment is proposed.
- (b) When necessary, any specific additional question unique to that proposed amendment;
- (c) The paragraphs of the FReM chapter that are affected by the proposed amendment;
- (d) The proposed effective date of each proposed amendment.

## **Invitation to comment**

---

HM Treasury invites comments on the proposed amendments. It would particularly welcome answers to the questions set out below. Comments are most helpful if they:

- (a) Answer the question as stated;
- (b) Indicate the specific paragraph or paragraphs to which they relate;
- (c) Contain a clear rationale; and
- (d) Describe any alternative HM Treasury should consider.

HM Treasury will consider all comments received in writing by 8<sup>th</sup> February 2010. In considering the comments, HM Treasury will base its conclusions on the merits of the arguments for and against each alternative, not on the number of responses supporting each alternative.

<b>Accounting for Capital Government Grants and Similar Financing from Non-Government Sources</b>	
Why the amendment is proposed	To provide clear guidance on the accounting for capital government grants and other capital non-exchange transactions, including aligning the treatment across government for WGA
Paragraph(s) affected by the amendment	Chapter 5 – paragraphs 5.4.55 to 5.4.57 Chapter 6 – 6.2.5 to 6.2.6, 6.2.18, 6.2.21 to 6.2.22 and 6.2.55 to 6.2.57 Chapter 7 - 7.2.10 Chapter 8 – 8.2.18 Chapter 11 – 11.2.18
Proposed date	2010/11

### **Background**

There are variations in the accounting treatment of capital non-exchange transactions (i.e. government grants, donations and lottery grants) within the FReM and across central and local government. This Exposure Draft identifies these differences and, alongside parallel work being undertaken by CIPFA, proposes an accounting methodology that is consistent across government.

### **Summary**

The proposal in this Exposure Draft is that all non-exchange funding of non-current assets is treated as income by the recipient and deferred only where the funder imposes a condition.

## **General questions (applicable to all proposed amendments)**

### **Question 1**

Do you agree with HM Treasury's proposal to amend the FReM as described in the exposure draft? If not, why not, and what alternative do you propose?

### **Question 2**

Do you agree with the proposed effective date? If not, why not, and what alternative do you propose?

## **Specific questions**

### **Question 3**

Do you agree with the proposed adaptation of IAS 20 so as to extend the scope of the Standard to donated assets? If not, why not, and what alternative do you propose?

### **Question 4**

Do you agree with the proposal to treat the funding element as income, which is only deferred where a condition is imposed by the funder? If not, why not, and what alternative do you propose?

### **Question 5**

Are the additional disclosures proposed for IAS 16 to provide visibility of government grants, donations and lottery funding received sufficient to provide users with an understanding of how assets are financed? If not, why not, and what alternative do you propose?

## **FReM chapters addressed**

The following table shows the topics addressed by these proposed amendments.

<b>FReM Chapter</b>	<b>Subject of amendment</b>
Chapter 5, Form and Content of Annual Report and Accounts	Remove references to donated asset and revaluation reserves
Chapter 6, Tangible Non-current Assets	Remove references to donated asset and revaluation reserves, new adaptation of IAS 20, additional disclosure requirements of IAS 16 and update accounting requirements pertaining to grants to NDPBs from sponsoring departments.
Chapter 7, Intangible Non-Current Assets	Revised guidance on EU Emissions Allowances accounting
Chapter 8, Impairments	Remove references to donated asset and revaluation reserves
Chapter 9, Income and Expenditure	Tidy up text relating to grants to NDPBs

# **Proposed Amendment to Government Financial Reporting Manual Chapter 5, *Form and Content of the Annual Reports and Accounts* and Chapter 6, *Tangible Non-Current Assets***

## **Introduction**

---

### *Background*

1. There has been some debate as to the status of lottery funding and this debate has led to the proposals in this paper. In Treasury's central government FReM lottery funding is accounted for as a donation, whereas in Monitor's Foundation Trust FReM this funding is treated as a government grant.

2. The Treasury issued a number of papers during 2008 consulting on the accounting arrangements for the financing element of lottery funded assets. The last of these resulted in a paper to the November 2008 FRAB, which proposed that lottery financing of capital assets be accounted for in a Lottery Funded Asset Reserve, following the FReM's donated asset model. The Board rejected this approach expressing the view that the donated asset FReM guidance should be reviewed, as the financing element does not represent an equity contribution within the meaning of IAS 32 *Financial Instrument Presentation* (i.e. a residual interest in the value of the assets of the entity after deducting liabilities). Therefore, in the hands of the recipient, lottery funding and donations represent income.

3. The Treasury has been working closely with CIPFA to develop an accounting solution for non-exchange transactions relating to capital assets (donations, lottery funding and government grants). This exposure draft outlines the options considered by the Treasury and CIPFA, and proposes a revised accounting methodology for the financing element of capital non-exchange transactions. The main issue considered in this exposure draft is: should capital grants and donations be deferred and recognised over the useful life of the relevant asset to match depreciation, or recognised immediately as income once any conditions have been met? Additionally, there are separate proposal that capital grants from sponsoring departments to NDPBs be treated as 'contributions from owners' following the current FReM treatment of revenue grants from sponsoring departments and that government grants for EU emission allowances be treated in the same way as is proposed for all capital government grants.

### *Existing FReM Accounting Requirements*

4. Assets financed by government grant and donations are subject to similar accounting arrangements. The value of the financing provided by government or the donor is taken to reserves, government grant or donated asset reserve, and released to the OCS over the life of the asset.

5. The accounting guidance in the FReM is driven by the legal status of the financier. If the asset is financed by a private individual or private sector entity it is treated as donated, whereas if a government body finances the asset it is accounted for as government grant funded.

6. The FReM requires at paragraph 6.2.18 that assets financed through a gift of funds are to be treated as donated - a donor need not donate the physical asset.

#### *Guidance Provided by Standard Setters*

7. IAS 20 *Accounting for Government Grants* provides guidance on accounting for revenue and capital grants from government bodies, which IAS 20 defines as 'government, government agencies and similar bodies whether local, national or international'. For capital grants IAS 20 requires that the financing element is either deducted from the value of the capital asset, or treated as deferred income released over the assets life. The FReM only permits the latter of these options requiring such income be recognised over the life of the relevant assets so as to match depreciation.

8. In its Project Summary, *Amendments to IAS 20 Accounting for Government Grants and Disclosure of Government Assistance* the IASB highlight the option to defer income as being inconsistent with its *Framework for the Preparation and Presentation of Financial Statement* (the Framework), as this deferred income does not represent a liability to the entity. The Project Summary also notes that such treatment is not that required by International Public Sector Accounting Standard (IPSAS) 23 *Revenue from Non-Exchange Transactions*, which the IASB states is compatible with its Framework.

9. IPSAS 23 requires that non-exchange revenue relating to capital items, i.e. capital grants and donations, is recognised immediately, except where the funding is subject to a condition<sup>1</sup> (as opposed to a restriction<sup>2</sup>) that would prevent immediate recognition. A condition represents a liability to the recipient and therefore revenue should be deferred until such time as the condition is discharged.

10. The ASB's *Statement of Principles for Public Benefit Entities* takes the same approach as IPSAS 23, requiring that capital grants and donations are recognised immediately except where the funding is subject to a condition.

#### *Accounting Options*

11. In developing the proposals in this paper, the Treasury and CIPFA have considered the above pronouncements and the needs of users. In addition, the Treasury and CIPFA have tried to develop proposals that align the accounting treatment across the two sectors that achieve consistency and minimise any misalignment for WGA, or within the Treasury's budgeting, Estimates and accounting frameworks<sup>3</sup>.

12. The IASB provides guidance on accounting for capital government grants but it does not provide guidance in respect of similar funding (whether in the form of assets or cash) from non-government sources. The FReM tackles this gap in the guidance by interpreting IAS 20, requiring that donated assets are accounted for in a similar fashion to government capital grants.

---

<sup>1</sup> Stipulations that specify that the future economic benefits embodied in the grant/contribution is required to be consumed by the recipient as specified or the grant/contributions must be returned to the transferor, e.g. a grant that is conditional on the construction of an asset.

<sup>2</sup> Stipulations that limit or direct the purpose for which a grant/contribution may be used, but does not specify that the grant/contribution is required to be returned to the transferor.

<sup>3</sup> At the October 2009 FRAB meeting the Board approved an amendment to the 2010/11 CIPFA code so that capital donations and grants are accounted for following the recommendation made in this FReM Exposure Draft.

13. IAS 18, *Revenue* offers no solution to this problem. The IASB's Framework makes clear that income contains two components, revenue and gains. Crudely put, revenue is earned, whereas gains are unearned. Donations would fall to be categorised as unearned and therefore are not covered by IAS 18. The scope of the standard supports this analysis.

14. In developing a suitable accounting methodology for donated assets it would appear necessary to adapt or interpret an existing standard, the options being;

- a) Adapt IAS 18 so that donations are treated as revenue;
- b) Adapt IAS 16 so as to provide guidance on the treatment of donated assets and government grants; or
- c) Interpret IAS 20 so that it covers similar transactions from non-government sources.

15. Adapting IAS 16 or IAS 18 would seem to be a poor fit; IAS 18 implies an exchange, as opposed to non-exchange transaction. While IAS 16 is concerned with capital asset recognition and measurement, it does not address the accounting treatment of capital government grants and donations.

16. An interpretation of IAS 20 would seem to be the sensible approach. There are two options;

- a) to adapt IAS 20 so that donated assets are within its scope and account for the financing of such assets in the same way as that for government grants; or
- b) to apply the adaptation at 16 a) and in addition further adapt IAS 20 so that the financing element is accounted for broadly following IPSAS 23, i.e. income is only deferred where the grant or donation is subject to a condition (as opposed to a restriction). It should be noted that as a consequence revaluations will be taken to the revaluation reserve and not the government grant or donated asset reserve, as these reserves will cease to exist.

17. It is clear from the IASB's Project Summary, *Amendments to IAS 20* that the creation of a deferred income liability is not regarded as best accounting practice. The Treasury and CIPFA have misgivings about aligning the donated assets requirements with the capital government grant requirements in IAS 20 as the IASB has itself highlighted that such accounting is not aligned with its own framework. The IASB consider that better accounting guidance has been issued by IPSASB. IPSASB standards are second in the hierarchy used to establish accounting policy for central and local government.

18. The accounting treatment described in paragraph 16 negates the need for separate guidance on lottery funding or the need to consider whether such funding is government or non-government, as all non-exchange capital funding will be accounted for in the same way.

19. Treasury proposes that the FReM is amended to reflect the accounting treatment detailed at 16 (b) above.

20. To ensure that users can still see how capital assets have been funded Treasury and CIPFA propose that entities provide additional disclosures within the fixed asset note showing how additions have been financed, i.e. own capital budget, government grant, donation, lottery funding.

#### ***Capital Grants to Sponsored NDPBs***

21. The FReM differentiates between capital and revenue grants; revenue grants are treated as contributions from owners, whereas capital grants are accounted for broadly following the requirements of IAS 20. The existing FReM treatment of capital grants does not appear to represent good GAAP. The FReM applies IAS 20 but requires capital grants are treated as equity. IAS 20 places equity contributions outside its scope. Treasury therefore proposes that capital grants from sponsoring departments are in future accounted for as contributions from owners (and not grants) aligning with the FReM guidance for revenue grants, such contribution being recognised in general reserves.

#### ***EU Greenhouse Gas Emission Allowance Trading Directive***

22. The FReM requires that for allowances issued for less than their fair value the difference between the amount paid and the fair value is recognised as a government grant: allowances issued by government for less than fair value representing capital non-exchange transactions. Following the proposals in this paper the ‘free’ element of such allowances should be accounted for as deferred income subject to a condition: the allowances provide the right to emit greenhouse gases and therefore this income should be matched with the recognition of the expense relating to this right (as the liability to deliver allowances is taken to the OCS). Any revaluation of allowances should be accounted for in the same way as revaluations of all other non-current assets.

#### ***Impact on Budgets***

23. The budgeting guidance will be amended so that there will be no budgetary disadvantage from accepting a grant or donation either in terms of the capital treatment on acquisition of an asset or of the revenue treatment of the depreciation. When a donation is received, it will be credited to capital DEL and the subsequent asset purchase will be debited to capital DEL so that there is no capital DEL consequence (unless the asset cost is more than the donation, in which case the excess cost will be met from capital DEL budgets).

24. When the grant is received there will be a resource AME credit of the same amount. As the asset is depreciated, the depreciation will be debited to resource AME, so that, over the life of the asset, the AME credit and debits cancel out.

## **Proposed amendment**

Amendments are proposed to the following paragraphs;

### **Chapter 5, Form and Content of Annual Report and Accounts, Paragraphs 5.4.55 to 5.4.57**

#### **Revaluation reserve**

5.4.55 The revaluation reserve should reflect the unrealised balance of the cumulative indexation and revaluation adjustments to assets, ~~other than donated assets and those funded by grants, including those from the EU. The note should give a detailed analysis of movements in the reserve.~~

#### **Donated assets reserve**

~~5.4.56 The donated asset reserve represents the net book value of assets donated to the entity — that is, the opening valuation of an asset adjusted by its revaluation and depreciation. The note should give a detailed analysis of movements in the reserve.~~

#### **Government grant reserve**

~~5.4.57 The government grant reserve reflects that proportion of the net book value of an asset financed by a government grant, including any from the EU. The notes to the accounts should give a detailed analysis of the movements in the reserve and should distinguish between UK grants and EU grants.~~

### **Chapter 6, Tangible Non-Current Assets, paragraphs 6.2.5 to 6.2.6, 6.2.18, 6.2.21 to 6.2.22 and 6.2.55 to 6.2.57**

~~6.2.5 The following general adaptations to IAS 16 apply to reporting entities required to prepare their financial statements in accordance with the guidance in this Manual.~~

#### ***Measurement***

~~Gains on revaluation of fixed assets should be credited to the relevant reserve as follows:~~

- ~~— Assets financed by grants in aid — the revaluation reserve (5.4.55)~~
- ~~— Donated assets — the donated asset reserve (5.4.56)~~
- ~~— Assets financed by grants, including any from the EU — the government grant reserve (5.4.57)~~

~~—  
Losses on revaluation should be debited to the relevant reserve (see above) to the extent that gains have been recorded previously, and otherwise to the operating cost statement.~~

6.2.6 In applying IAS 16, reporting entities should be aware of the following interpretations for the public sector context.

### *Recognition and measurement*

- a) All tangible fixed assets shall be carried at valuation at the reporting period – that is, the option given in IAS 16 to measure at cost has been withdrawn, as has the option to value only certain classes of assets.
- b) It is not necessary to disclose the historical cost carrying amounts (where available) as required by IAS 16.
- c) In considering the treatment of any interest at initial recognition, entities shall not capitalise any cost of capital charge associated with the item of property, plant or machinery.
- d) The 'value in use' of a non-cash-generating asset is the present value of the asset's remaining service potential, which can be assumed to be at least equal to the cost of replacing that service potential.

### Disclosure

As part of the Property, Plant and Equipment note entities should, in the year the asset is acquired, separately disclose the fair value of those asset funded by government grant, donation or lottery funding. Where the funder provides cash, rather than the physical assets, any difference between the cash provided and the fair value of the assets acquired should also be disclosed.

~~6.2.18~~ Assets donated by third parties (see also paragraph 6.2.23), either by gift of the asset or by way of funds to acquire assets (including national lottery-funded assets), and which meet the criterion in paragraph 6.2.19, should be capitalised at fair value on receipt. Where the value of the services provided by an asset will be less than the fair value of the asset because it is over-specified for its intended use, the lower value should be used. ~~The amount capitalised should be credited to a donated asset reserve. The funding element should be recognised as income as required by IAS 20 as adapted in this Manual paragraph 6.2.2. (b) refers.~~

6.2.21 Donated assets should be revalued, depreciated and subject to impairment review in the same way as other fixed assets. ~~Revaluations should be taken to the donated asset reserve. Each year, an amount equal to the depreciation charge on the asset and any impairment should be released from the donated asset reserve to the operating cost statement.~~ No cost of capital charge will be imposed.

6.2.22 Details of any restriction or condition s imposed by the donor on the use of the donated asset should be disclosed in a note to the financial statements.

6.2.55 In applying IAS 20 and SIC 10, entities should be aware of the following interpretations and adaptations for the public sector context.

### Interpretations of IAS 20, and SIC 10 for the public sector context

#### *Recognition*

- a) Parliamentary Supply (the parliamentary grant in Wales) does not fall within the meaning of government grants;
- b) ~~Entities receiving a grant (not grant-in-aid) to fund the purchase of a specific asset should credit that grant to a government grant reserve which should be released to income over the useful life of the asset.~~ The option provided in

IAS 20 to offset the grant against the cost of the asset ~~is not available~~ has been withdrawn.

### Adaptation of IAS 20, and SIC 10 for the public sector context

#### Scope

a) Donated assets are within the scope of IAS 20

#### Recognition and measurement

b) Where assets are financed by government grant or donation the funding element is recognised as income and taken through the OCS. This income is only deferred where the funder imposes a condition: a condition is a requirement that the future economic benefits embodied in the grant/donation must be consumed as specified by the grantor/donor or must be returned to them, e.g. a grant that is conditional on the construction of an asset.

c) A grant, contribution or donated asset may be received subject to a condition that it be returned to the transferor if a specified future event does or does not occur (for example, a grant may need to be returned if the authority ceases to use the asset purchased with that grant for a purpose specified by the transferor). In these cases, a return obligation does not arise until such time as it is expected that the condition will be breached and a liability is not recognised until that time. Such conditions do not prevent the grant, contribution or donated asset being recognised as income in the Statement of Comprehensive Net Expenditure.

### **Other requirements**

6.2.56 The following requirements should be observed by entities covered by this Manual.

- a) The notes to the financial statements should distinguish between grants from UK government entities and grants from the European Union.
- b) As it is important for monitoring and control purposes, entities that receive grant in aid that is intended to finance both revenue and capital expenditure should analyse the grant in aid between its constituent parts, notwithstanding that it will be credited in total to the income and expenditure reserve.

### **Summary of accounting treatment for grants from sponsoring Department to their NDPBs**

6.2.57 Grants and grants-in-aid shall be accounted for as follows:

- a) grants-in-aid, whether for revenue or capital purposes, are to be treated as contributions from controlling parties giving rise to a financial interest in the residual interest of the reporting entity, and are to be credited to general reserves and not, ~~respectively,~~ to income or deferred income. ~~In the case of~~

- ~~grants-in-aid for general capital purposes, it will not be necessary to release amounts to the income and expenditure account to offset reserves;~~
- b) ~~where it can be demonstrated that~~ grants for revenue purposes ~~will normally be accounted for in the same way as grants-in-aid, unless it can be demonstrated that they~~ are provided in return for specific goods or services ~~i.e. they are contractual, in which case they are to~~ should be credited to income—; ~~Any proposal to account for grants as income in this way should be approved by the sponsoring department and the relevant authority.~~ ; ~~In all other cases grants will be accounted for in the same way as grants-in-aid.~~
  - c) ~~grants provided to finance the purchase of a specific fixed asset are to be credited to a government grant reserve which is released to income over the useful economic life of the asset;~~
  - d) ~~on disposal of an asset financed by a grant, the profit or loss is taken to the income and expenditure account/operating costs statement and is offset by a transfer from the government grant reserve of the same proportion of the profit or loss that the amount of the grant bears to the original cost of the asset. The balance on the government grant reserve in respect of that asset should be transferred to the income and expenditure reserve/general fund representing that same proportion of the proceeds;~~
  - e) the profit or loss on disposal of an asset financed by grant-in-aid is taken to the income and expenditure account/operating cost statement; and
  - f) grant-in-aid is provided to match the recipient's cash needs and is to be accounted for on a cash basis. Any exceptions to this treatment must be agreed by the sponsoring department and the relevant authority.

## **Chapter 7, Intangible Non-Current Assets, Paragraphs 7.2.10**

~~7.2.10~~When allowances are issued for less than their fair value, the difference between the amount paid and fair value ~~represents a government grant that is subject to a condition, as per the adaptation of IAS 20is a government grant. The income element should be deferred and released to the OCS as the liability to emit greenhouse gases is recognised through the OCS. The government grant reserve should be credited with the same proportion of the amount of the revaluation, which the amount of the grant bears to the acquisition cost of the asset~~The allowances should be revalued in the same way as all non-current assets. The remainder of the revaluation is credited to the revaluation reserve.

## **Chapter 8, Impairments, Paragraphs 8.2.18**

8.2.18 Downward revaluations result in an impairment only where an asset is revalued below its historical cost carrying amount. In these cases, the accounting treatment is as for any other impairment. All other downward movements (for example, as a result of market fluctuations) should be accounted for through the revaluation ~~(or donated asset or government grant)~~ reserve to the extent that there is a credit in that reserve that relates to the revalued asset or portfolio of assets.

## **Chapter 11, Income and Expenditure, Paragraphs 11.2.18,**

11.2.18 Other than charitable NDPBs, who should follow the requirements of the Charities SORP, NDPBs should regard grants and grants-in-aid ~~received for revenue purposes~~ as contributions from controlling parties giving rise to a financial interest in the residual interest of the body, and hence should account for them as financing, i.e. by crediting them to the income and expenditure reserve. The treatment of grants and grants-in-aid ~~is explained received for capital purposes is described~~ in chapter 6 (paragraph 6.2.57). Any proposal for alternative accounting treatment should be approved by the department responsible for the NDPB and the relevant authority.

### **Effective date of amendment**

The effective date for the proposed amendment is 1 April 2010.