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GUIDANCE ON ACCOUNTING ISSUES ARISING FROM THE SINGLE PAYMENT SCHEME

*Guidance on accounting issues arising from the Single Payment Scheme, issued in May 2005
by The Institute of Chartered Accountants of Scotland and the Institute of Chartered
Accountants in England and Wales.*

CONTENTS

	Paragraph
Introduction	1
The Common Agricultural Policy	2 - 3
The Single Payment Scheme	4 - 14
Recognition of Single Payment Income	15 - 31
Recognition of the Payment Entitlement as an Asset	32 - 44
Appendix A - Legislation	
Appendix B - Examples	

This Technical Release provides general guidance and does not purport to deal with all possible questions and issues that may arise in any given situation. No responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this guidance can be accepted by the Institutes.

Introduction

1. The purpose of this Technical Release is to set out guidance on accounting issues arising from the Single Payment Scheme¹ (SPS). This Technical Release reflects the law² at 29 April 2005 and accounting standards³ in issue at that date.

The Common Agricultural Policy

2. The basic principles on which the Common Agricultural Policy (CAP) was built were set out in the Treaty of Rome in 1957. From the mid 1960s and throughout the 1970s financial assistance was provided for the restructuring of farming and to subsidise production. By the 1980s, the EU had to contend with almost permanent surpluses of major farm commodities. As a result, in the 1990s, important reforms were agreed which involved reducing support prices and compensating farmers by paying them direct aids. Production limits helped reduce surpluses. Farmers had to look more to the market place, while receiving direct income aid, and to respond to the public's changing priorities. This shift of emphasis in the CAP entered a new phase with agreement in 1999 on the so-called 'Agenda 2000' reforms.
3. The SPS is part of the CAP Reform arrangements that were agreed in June 2003. The SPS will be subject to a review in 2007. It is possible that it may then be extended or amended. It is always a possibility that a new subsidy scheme may be introduced or subsidies dropped altogether.

The Single Payment Scheme

4. The new regime provides for a Single Payment (SP) to replace most existing farm subsidy schemes.
5. Unlike the previous subsidy, the SP is de-coupled in that payment is not dependent on the farmer maintaining any specified level or type of production. However, in order to receive the full payment, the farmer will have to meet a number of Cross-Compliance conditions which include specified environmental conditions and animal health and welfare standards.
6. The operation of the SPS will differ slightly in the separate jurisdictions of Scotland, England, Wales and Northern Ireland⁴, but is sufficiently similar for the accounting implications to be addressed in this single guidance statement.⁵

1 The scheme is called the Single Farm Payment Scheme in Scotland, but the Single Payment Scheme in England, Wales and Northern Ireland.

2 The SPS is part of the package of measures agreed under the heading of Common Agricultural Policy Reform. See Appendix A for details of implementing legislation in the UK.

3 This Technical Release addresses the accounting treatment under UK GAAP.

4 In Scotland and Wales, the administrations have opted for payments based solely on the individual historic entitlement (IHE), while England's scheme is a dynamic hybrid model, including elements of both IHE and regionalised area payments (RAP). Northern Ireland has adopted a static hybrid scheme where the proportion paid on IHE and RAP will remain the same.

5 See paragraph 11 for details of differences between the jurisdictions concerning the 10 month basis period.

7. Eligible farmers will be able to establish entitlements to the SP using forms circulated in spring 2005, thus essentially receiving an intangible asset known as the Payment Entitlement (PE). Once definitively established (at around the turn of the year), the PE will be tradeable (subject to restrictions) and can be sold or leased. There will be various classes of entitlement, with differing rates of payment within each class.
8. The period to which an SP claim relates follows the calendar year from 1 January to 31 December. Payments are expected to be made within the period from 1 December in the year of claim up to 30 June in the following year.
9. A farmer's entitlement to the SP needs to be formally established by application by 16 May 2005. (Claims will be accepted up until 10 June 2005 but will be subject to late claim penalties.) It is only when all entitlements have been established that the actual value of each entitlement will be calculated and notified to farmers.
10. A farm becomes entitled to the SP for a calendar year if:
 - a) a claim is made by 15 May in the year of claim (except where this date falls on a weekend);
 - b) the PE and the qualifying farm land are held for the whole of a chosen basis period (of at least ten months) – the Eligibility condition; and
 - c) the specific qualifying conditions relating to the care of the land, animal husbandry etc are maintained for at least the chosen ten month basis period and for any additional period in which the land is available to the farmer in the calendar year of claim – the Cross-Compliance conditions.
11. The ten month basis period can commence at any time between 1 October prior to the year of claim and 30 April within the year of claim: if the farmer does not elect a specific period, the basis period is taken to run from 1 February to 30 November in the year of claim. It is not possible to have an overlap of chosen basis periods for two consecutive years of claim. The farmer cannot elect to have different ten month periods for different parts of the farm. There must be a common period applied to the whole farm.

[In cases where the farm includes land taken in let, a recent change to the legislation has been made at EU level. It is understood that farmers who use rented land can elect to divide the farm into two parcels and have a different ten month basis period for each. The Scottish Executive has indicated its intention to implement this change in 2005 and it is anticipated that it will be implemented in the other jurisdictions in 2006. An update to this Guidance Note will be issued once more details of the amendment to the legislation have been ascertained and the accounting implications assessed.]

12. Failure to comply with the Eligibility condition would result in a total loss of SP, although it should be noted that failure to occupy part of a holding would lead to a loss of subsidy only on that proportion of the claim. Failure through negligence to comply with any of the Cross-Compliance conditions would normally be dealt with by a reduction in SP of between 3 to 5%, building to 15% for repeated non-compliance. This penalty may be reduced to 1% where minor breaches have been identified. The authorities may decide to issue a warning letter for only very minor and technical infringements. Intentional non-compliance would result in a minimum 20% reduction to the SP (although a penalty could be reduced to 15% in less serious non compliance) and may even result in exclusion from the SPS the following calendar year. In extreme cases, eg gross animal cruelty or deliberate use of land for an environmentally destructive activity, it is possible that the whole SP might be lost, or required to be returned. In addition, it should be noted that enforcement agencies may also consider pursuing criminal action in cases of serious non-compliance where Cross-Compliance standards are reflected in law.
13. Non-compliance with the Eligibility and Cross-Compliance conditions will be identified at inspections by various bodies⁶. Although the inspection regimes are still under development at the time of writing, it is understood that:
 - a) approximately 5% of farms will be inspected each year in relation to satisfying the Eligibility test (ie re the ten month basis period);
 - b) approximately 1% of farms will be inspected each year on each relevant aspect of the Cross-Compliance conditions (by the relevant authority for each condition), although reported non-compliances identified via inspections undertaken by the various enforcement agencies (outside of the 1% selection) might also incur cross-compliance penalties;
 - c) both inspection regimes will be risk based;
 - d) any non-compliance with the Cross-Compliance conditions discovered during an inspection will result in application of a penalty for that year of claim. Other than for serious non-compliance, penalties are unlikely to be applied retrospectively;
 - e) any penalty arising from non-compliance with the Cross-Compliance conditions will be applied to the whole of the farm's claim and not only in relation to the acreage subject to the non-compliance.
14. It is therefore unlikely that an inspection will be made of an individual farm in any one year of claim. If an inspection does take place, this might occur during the chosen ten month basis period or at some other time during the SP year of claim. If the SP had already been paid for the year of claim and the qualifying conditions were found not to have been met, there would be some clawback of the appropriate part of the amount of SP paid.

⁶ In Scotland, the Scottish Executive Environmental and Rural Affairs Department (SEERAD), the Scottish Environment Protection Agency (SEPA) and others and the equivalent authorities in England, Wales and Northern Ireland.

Recognition of SP income

SSAP 4

15. In the UK, accounting for government grants is governed by SSAP 4 “Accounting for Government Grants”. Paragraph 23 requires that, if a grant is made to finance the general activities of an enterprise over a specific period (as the SP is), it should be recognised in the Profit and Loss Account of the period in respect of which it is paid. However, paragraph 24 requires that SPs should not be recognised in the Profit and Loss Account until the conditions attached to the grant have been complied with and there is reasonable assurance the grant will be received.

Triggering recognition

16. SSAP 4 requires that recognition does not take place until there is both compliance with the relevant conditions for receipt of the SP and reasonable assurance as to receipt.
17. The conditions are set out in paragraph 10 above. Condition (a) is necessarily satisfied first. Condition (b) is satisfied at the end of the chosen ten month basis period. Condition (c), in theory, could be regarded as not satisfied until the end of the year of claim, or the end of the basis period if later. Therefore, under a strict application of SSAP 4, the conditions might only be said to have been satisfied at the later of:
 - midnight on 31 December in the year of claim; and
 - the end of the chosen ten month basis period.
18. However, it is difficult to ascertain when compliance by a farmer with the Cross-Compliance conditions could be said to be reasonably certain. It has been suggested that most of the Cross-Compliance conditions are manageable and achievable for the majority of farms and, indeed, these will normally be complied with as a matter of course. Moreover, it is understood that less than 10% of farms will be subject to inspection in any one year of claim. Therefore, for the vast majority of farms not subject to inspection in the year of claim, admission of non-compliance will essentially be voluntary:
 - a) in the main, farmers will be unaware of unintentional non-compliance (by definition), unless this is identified by them, their advisers, accountants or auditors, or other third parties during the course of the year. If the farmer reports such non-compliance, then the appropriate penalty will be suffered (3 to 5% of the SP for that year, possibly rising to 15% for repeated unintentional non-compliance);
 - b) in cases of intentional non-compliance, it would seem unlikely that farmers would wish to report this to the authorities or to their accountants or auditors and, in the absence of an inspection or the discovery of non-compliance by the accountants or auditors or other third parties, this would be likely to remain undiscovered.

19. Furthermore, other than in cases of major intentional non-compliance, subsequent inspections are unlikely to result in penalties being applied retrospectively. Even after the end of the calendar year of claim or the ten month basis period, if later, it is possible that unintentional non-compliance which had existed during the year of claim may subsequently be discovered. For a diligent and honest farmer, however, the penalties for any such non-compliance subsequently discovered are unlikely to be applied retrospectively.
20. For practical purposes, it would therefore be the case that, once the ten month basis period had been completed, the Cross-Compliance conditions could be assumed to be satisfied for a year of claim unless:
 - a) an inspection has taken place during the ten month basis period (or any part of the calendar year of claim prior to that ten month period) and discovered non-compliance; or an inspection has taken place (or is to take place) before the end of the calendar year of claim if this is later than the end of the ten month basis period; or
 - b) there is other evidence of non-compliance.
21. Given the likely achievability of the Cross-Compliance conditions and the limitations of the inspection and penalty regimes, condition (c) does not seem to be significant to the timing of the recognition of the SP or for determining the amount recognised.
22. Accordingly, it is recommended that the trigger for recognition of the SP should be the end of the ten month basis period for the year of claim.

Recognition of SP

23. SSAP 4 requires the SP to be recognised in the Profit and Loss Account of the calendar year in respect of which it is paid. Unless some other basis seems more appropriate, this would be recognised evenly on a time basis. [Example 1 in Appendix B illustrates a simple case – where, by the end of both the financial year and the calendar year, the conditions for receipt of the grant have been met and there is reasonable assurance that the grant will be received.]
24. However complications arise where the conditions are not met until after the end of the financial year. The question then arises as to whether the SP should be recognised in the accounting period during which the ten month basis period ends or whether it should be recognised in the calendar year to which it relates.

25. Paragraph 24 of SSAP 4 is quite clear in stating that "...a government grant should not be recognised in the profit and loss account until the conditions for its receipt have been complied with...". Under FRS21 "Events after the Balance Sheet Date", events that provide evidence of matters that existed at the balance sheet date are adjusting events and the entity should adjust the amounts recognised in its financial statements or recognise items that were not previously recognised. The relevant condition for receipt of the SP is to hold the land for the whole of the chosen basis period, and the situation at the balance sheet date was that this condition for receipt had not yet been complied with. The end of the ten month period is therefore not an adjusting post balance sheet event. [See Example 2 in Appendix B.]
26. If a farmer retains the same basis period and accounting period each year, each set of annual financial statements will include 12 months of SP.
27. However, an anomaly can arise when the farmer changes the ten month basis period, with two years of SP being recognised in the same financial statements. [See Example 3 in Appendix B.] This situation gives rise to questions as to the consistency of accounting treatment and whether the financial statements for the years affected actually give a true and fair view. Paragraph 15 of FRS 18 "Accounting Policies" states that "...if in exceptional circumstances compliance with the requirements of an accounting standard...is inconsistent with the requirement to give a true and fair view, the requirements of the accounting standard...should be departed from to the extent necessary to give a true and fair view...". The general understanding is that the true and fair override should only be used to override an accounting standard in the special circumstances of an individual entity that has a different situation from most other entities. Paragraph 16 of FRS 18 states that "an entity will not depart from the requirements of an accounting standard...where a true and fair view can be achieved by additional disclosure". Therefore, other than in exceptional circumstances, the matter should be dealt with by complying with SSAP 4 and making appropriate disclosures in the notes to the accounts.

Provision for Non-Compliance with the Cross-Compliance conditions

28. Once recognition has been triggered, 100% of the SP for the year of claim should be recognised as receivable. Given the nature of the Cross-Compliance conditions and the limitations of the inspection and penalties regimes, it would normally be acceptable for 100% of the SP to be recognised as receivable at the end of the ten month period, even if this occurs before the end of the calendar year of claim.
29. Recognition should only be deferred where there are reasons for believing that the farmer will not be able to comply with the conditions attached to the grant.
30. Any provision to repay the grant (in whole or in part) should only be established to the extent that repayment is probable.

Early Receipt of SP

31. Paragraphs 6 and 27 of SSAP 4 address the circumstances where the SP has been received by the farmer prior to the accounting year end. If the accounting year end is prior to the end of the ten month basis period, then the SP received would need to be carried forward in the balance sheet as deferred income/creditor until the end of the ten month period. If the accounting year end is after the end of the ten month basis period, the SP received would be recognised in the Profit and Loss Account (on a time basis) and any provision to repay the grant (in whole or in part) should only be established to the extent that repayment is probable.

Recognition of the PE as an Asset

Initial Recognition

32. The PE is an intangible asset which is created by the filing of the first claim after 1 January 2005. This entitlement would appear to have a useful life whilst the SPS is in operation as described here or if some other subsidy regime is introduced with qualification based on previous SP eligibility.⁷
33. FRS 10 “Goodwill and Intangible Assets” covers the accounting treatment of intangibles and defines them as non-financial assets:
- with no physical substance;
 - which can be separately identified; and
 - which can be controlled by the entity through legal or custody rights.

FRS 10 specifically includes licences and quotas in its definition of intangible assets. A PE is similar to these, which indicates that it should be regarded as an intangible asset.

34. It is not clear whether FRS 10 would regard the PE as a “purchased” or an internally developed intangible asset, as it shows characteristics of both. A purchased intangible asset should be capitalised at cost or, if acquired as part of an acquisition of a business, at fair value (based on a readily ascertainable market value). If the PE is deemed to be “purchased”, then the “purchase” cost is zero.
35. An internally developed asset may be capitalised only if it has a readily ascertainable market value (FRS 10 paragraph 14). FRS 10 defines such a market value as being where:
- The asset belongs to a homogeneous population of assets which are equivalent in all material respects; and
 - There is an active market, evidenced by frequent transactions for that population of assets.

In that event the credit side of the double entry would be to deferred income, in accordance with SSAP 4, and this deferred income would subsequently be amortised to the profit and loss account for each year over the period to 2012 on the same basis as the amortisation of the intangible asset (and these would therefore cancel out to zero).

⁷ Entitlements may be lost and revert to the national reserve if not utilised according to the SPS usage rules.

36. Criterion (a) is satisfied but it is unlikely that criterion (b) could be satisfied at the inception of the SP scheme.
37. On this basis, the PE should not be recognised as an asset (or should be recognised at nil cost).

Purchase of a PE at a subsequent date

38. If a PE is purchased at a subsequent date, it would normally be carried at cost in the balance sheet under intangible fixed assets. Fixed assets are defined in the Companies Act as “assets...which are intended for use on a continuing basis in the company’s activities”. Therefore the PE will be held as a fixed asset if it is intended to be held so as to match with eligible land and generate entitlement to annual SP. Although not addressed by FRS 10, if the PE is merely held for transitional reasons or for trading, it would be recognised as a current asset at the lower of cost and net realisable value.

Revaluation

39. A PE held as a fixed asset may be revalued if it has a readily ascertainable market value. In such cases, the revaluation would be taken to an intangible asset revaluation reserve. Any transfer from this reserve to the Profit and Loss Account Reserve by way of amortisation or on disposal, would be by way of transfer between reserves and would not impact on the Profit and Loss Account.

Amortisation and Impairment

40. If the PE is not initially recognised as a fixed asset, amortisation is not an issue. However, if the PE is initially recognised as a fixed asset or if a farmer purchases a PE as a fixed asset, then this will become a matter for consideration.
41. FRS 10 requires that an intangible asset must be amortised over its useful life (a period of up to 20 years) or be subject to annual impairment reviews. The initial carrying value or purchase price of the PE would therefore need to be amortised on a straight line, or some other more appropriate basis, over the period from inception or date of purchase to the end of the asset’s useful life or, if sooner, the termination of the SPS.
42. However, if the farmer’s circumstances changed such that land to support an SP claim is no longer held, then the carrying value of the PE should be reviewed and, if appropriate, an impairment write down made.

Disposal

43. On disposal of a PE obtained as a result of the filing of the first claim after 1 January 2005, a profit or loss on sale would arise representing the difference between the sale proceeds and the book value (ie nil or amortised initial carrying value) at the date of sale.
44. On disposal of a purchased PE, a profit or loss on sale would arise representing the difference between the sale proceeds and the book value (ie the amortised purchase cost) at the date of sale.

LEGISLATION

The general rules for the operation of the SP Scheme are laid down in European Council (EC) Regulation 1782/2003 and Commission Regulations 2237/2003, 795/2004 and 796/2004.

The implementing legislation in the UK at 29 April 2005 is as follows:

Scotland

SI 2004 No 518	The Common Agricultural Policy Schemes (Cross-Compliance) (Scotland) Regulations 2004
SI 2005 No 218	The Common Agricultural Policy Single Payment and Support Schemes (Integrated Administration and Control System) Regulations 2005
SI 2005 No 143	The Common Agricultural Policy Single Farm Payment and Support Schemes (Scotland) Regulations 2005
SI 2005 No 117	The Agricultural Subsidies (Appeals) (Scotland) Amendment Regulations 2005

England

SI 2004 No 2689	The Common Agricultural Policy Single Payment and Support Schemes (Appeals) (England) Regulations 2004
SI 2004 No 3196	The Common Agricultural Policy Single Payment and Support Schemes (Cross-Compliance) (England) (Regulations) 2004
SI 2004 No 3385	The Common Agricultural Policy Single Payment Scheme (Set-Aside) (England) Regulations 2004
SI 2005 No 218	The Common Agricultural Policy Single Payment and Support Schemes (Integrated Administration and Control System) Regulations 2005
SI 2005 No 219	The Common Agricultural Policy Single Payment and Support Schemes Regulations 2005

Wales

SI 2004 No 3280 (W284)	The Common Agricultural Policy Single Payment and Support Schemes (Cross-Compliance) (Wales) (Regulations) 2004
SI 2005 No 45 (W4)	The Common Agricultural Policy Single Payment Scheme (Set-Aside) (Wales) Regulations 2005
SI 2005 No 218	The Common Agricultural Policy Single Payment and Support Schemes (Integrated Administration and Control System) Regulations 2005
SI 2005 No 360 (W29)	The Common Agricultural Policy Single Payment and Support Schemes (Wales) Regulations 2005

Northern Ireland

SR 2004 No 512	The Common Agricultural Policy Support Schemes (Hardship Notification) (Northern Ireland) Regulations 2004
SR 2005 No 6	The Common Agricultural Policy Single Payment and Support Schemes (Cross-Compliance) (Northern Ireland) (Regulations) 2005
SI 2005 No 218	The Common Agricultural Policy Single Payment and Support Schemes (Integrated Administration and Control System) Regulations 2005
	Note: Two Statutory Rules are still to be published.

EXAMPLES

Example 1

Consider a farmer with an accounting year end of 31 December and a ten month basis period ending on 31 August 2006 for the 2006 year of claim. The farmer has lodged the claim by 15 May 2006. It is envisaged that the farmer will meet the Eligibility and Cross-Compliance conditions and that the SP will be received.

No SP would be recognised up to 31 August 2006. At that date, a receivable of 100% of the SP would be recognised, with eight twelfths taken to the Profit and Loss Account at that time. The remaining four twelfths (of 100% of the SP) would be taken to deferred income to be released over the remaining four months of the calendar year. Thus, by 31 December, 100% of the SP would have been recognised.

Example 2

Consider a farmer with an accounting year end of 30 November and a ten month basis period ending on 31 January 2006 for the 2005 year of claim. The farmer has lodged the claim by 16 May 2005. It is envisaged that the farmer will meet the Eligibility and Cross-Compliance conditions and that the SP will be received.

Subject to a valid claim being made by 16 May 2005, the 2005 SP claim is therefore triggered on 31 January 2006. All of the SP for 2005 would be recognised in the accounting period in which the 10 month basis period ends ie in the financial statements for the year ending 30 November 2006.

Example 3

Assume the farmer in Example 2 then changes the ten month basis period so that the 2006 claim period ends on 30 November 2006. Subject to a valid claim being made by 15 May 2006, the 2006 SP claim is therefore triggered on 30 November 2006. All of the SP for 2006 would be recognised as a receivable in the accounting period in which the ten month basis period ends ie in the financial statements for the year ending 30 November 2006.

However, only 11/12 of the 2006 SP would be included in the Profit and Loss Account for the year ended 30 November 2006. That Profit and Loss Account would also include the whole of the 2005 SP.