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Legal briefing

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GRANTS AND FUNDING PROGRAMS: LEGAL ISSUES

Commonwealth grant programs extend to a wide range of funding activities. In this briefing we look at:

- **Commonwealth policy applying to grants—in particular, the Commonwealth Grant Guidelines (CGGs)**
- **establishing grant relationships**
- **the funding agreement and managing grant relationships**
- **issues that can arise when ending the grant relationship.**

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Commonwealth legal and policy framework

Commonwealth Grant Guidelines

The CGGs establish the policy framework for grants administration by *Financial Management and Accountability Act 1997* (FMA Act) agencies. The CGGs took effect on 1 July 2009. We first give an overview of the CGGs and then discuss other FMA and legal requirements that are applicable to grants.

The CGGs are divided into two parts:

- Part 1 of the CGGs contains mandatory decision-making and reporting requirements that apply to ministers and agency officials involved in grants administration.
- Part 2 of the CGGs sets out seven key principles of good practice for the administration of Australian Government grants. There is scope for agencies to determine the most appropriate way to implement these key principles for each of their granting activities.

The CGGs were issued by the Finance Minister under reg 7A of the *Financial Management and Accountability Regulations 1997* (FMA Regulations). The CGGs do not apply to bodies subject to the *Commonwealth Authorities and Companies Act 1997* (CAC Act).

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This issue

In the CGGs, 'Grants administration' includes planning and design, selection and decision making, making a grant, managing funding agreements, reporting, and review and evaluation (CGGs, para 2.4). Therefore, agencies need to ensure that they are compliant with the CGGs throughout the entire process related to the making of a grant.

A 'grant' is defined in FMA reg 3A[1] as:

> an arrangement for the provision of financial assistance by the Commonwealth:
>
> (a) under which public money is to be paid to a recipient other than the Commonwealth; and
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> (b) which is intended to assist the recipient achieve its goals; and
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> (c) which is intended to promote 1 or more of the Australian Government's policy objectives;
>
> and
>
> (d) under which the recipient is required to act in accordance with any terms or conditions specified in the arrangement.

The CGGs and FMA reg 3A(2) also specify what arrangements are not 'grants': including, but not limited to, procurement, loans, investments, payments to States and Territories covered by the *Federal Financial Relations Act 2009*, certain local government and education payments, and payments for Australia's international development assistance program.

What constitutes a 'grant' is discussed in more detail in Finance Circular 2009/03: *Grants and other common financial arrangements* (available through <www.finance.gov.au/grants>).

This circular also discusses other types of financial arrangements, including sponsorship and membership arrangements. It states that the nature of a particular financial arrangement should be determined by considering the substantive purpose and the characteristics of the arrangement rather than the particular name that may have been given to the arrangement.

The nature of a particular financial arrangement should be determined by considering the substantive purpose ...

Mandatory grant administration process requirements

The CGGs contain the following mandatory grant-specific process, decision-making and reporting requirements that apply to ministers (CGGs, paras 3.18 to 3.25):

- Where the minister is the approver of a grant for the purposes of the FMA Regulations, the minister will not approve the grant without first receiving department or agency advice on the merits of the proposed grant.
- A decision involving the award of a grant within a minister's own electorate (House of Representative members only) will remain within the remit of the responsible minister or other approver in the portfolio or agency concerned. But, if the minister approves a grant in respect to their own electorate, the minister is required to advise the Finance Minister in writing of the details of the grant as soon as is practical after the decision is made.
- A decision involving the award of a grant which the relevant agency has recommended be rejected will remain within the remit of the responsible minister, but the minister is required to report annually to the Finance Minister by 31 March setting out the details and basis of approval of any such grant approved by the minister. However, if the minister is a House of Representatives minister and the decision to approve a grant that the relevant agency recommended be rejected relates to the minister's own electorate, the minister is required to notify the Finance Minister of the grant's details and the basis on which the minister has approved the grant, as soon as is practical after that decision is made.

Agency requirements

Agency officials are responsible for advising their ministers of the CGG requirements and must take appropriate steps to do so in a timely manner where a minister exercises the role of a financial approver of a grant.

The CGGs include web-based reporting requirements (CGGs, paras 4.1 to 4.6). The CGGs require each agency to publish on its website information about its individual grants no later than seven working days after the funding agreement for the grant takes effect (the date of effect may be the date the funding agreement is signed, or a specified commencement date or may relate to a specified event) and retain that information on its website for two financial years.

The CGGs require each agency to publish on its website information about its individual grants no later than seven working days after the funding agreement for the grant takes effect ...

If an agency determines that public reporting of grants in accordance with the CGGs is contrary to the *Privacy Act 1988,* other statutory requirements, or the specific terms of a funding agreement, the agency:

— must endeavour to publish as much of the required grant information as legally possible

— must document the reasons for not reporting fully

— should take all possible steps to ensure that future funding agreements do not prevent the disclosure of the required information.

If an agency determines that publishing grant information in accordance with the CGGs could adversely affect the achievement of government policy outcomes, the responsible minister should write to the Finance Minister detailing the case for exemption from these web publishing requirements.

Finance Circular 2009/04: *Grants—Reporting Requirements* provides further information on the ministerial and agency reporting requirements specified in the CGGs (available through <www.finance.gov.au>).

The CGGs also state that agency officials must ensure that:

— guidelines for any new grant program are provided to the Expenditure Review Committee for its consideration (where the guidelines for an existing grant program are proposed to be amended, agencies should consult with the Department of Finance and Deregulation on whether the amendments require consideration by the Expenditure Review Committee)

— grant guidelines and related operational guidance are consistent with the CGGs

— grant guidelines for new grant programs are publicly available, including on the agency's website

— they behave in accordance with the law, government policy, agency rules (e.g. Chief Executive's Instructions) and the terms of applicable funding agreements

— they keep commercially sensitive information secure and never use it for personal gain or to prejudice grants administration processes

— they disclose information that the Australian Government requires be notified

— they disclose to their agency any current or prospective personal interest that might create a conflict of interest in grants administration (see CGGs, para 3.15).

Key principles for good grant administration

Part 2 of the CGGs establishes seven key principles for sound grants administration. While the requirements in Part 2 of the CGGs are not mandatory, agencies should have regard to these key principles, outlined below, in administering grants.

Robust planning and design

Grant processes should take account of all relevant risks in order to achieve the Australian Government's policy objectives in a transparent and accountable way.

An outcomes orientation

Agencies should focus on the results that a grant will achieve for the Australian community. They should maximise the grant's outcomes and outputs while making the most efficient and effective use of inputs.

Proportionality

Agencies should design a granting activity so that it is commensurate with the scale, nature, complexity and risks involved in that activity.

Collaboration and partnership

Without detriment to the other principles, agencies should develop and maintain constructive and cooperative relationships with grant recipients and other stakeholders.

Governance and accountability

Agencies should develop all policies, procedures and guidelines necessary for sound grant administration, including:

— defining the role of each party in the granting activity (this would include the minister, agency officials, the grant recipient and other stakeholders) to achieve the desired policy intent

— conducting all grant selection processes in a defensible manner

— negotiating funding agreements that clearly document the expectations of both parties in the delivery of the granting activity and enable the agency and recipient to be accountable for the grant funds

— maintaining accurate records on grant-giving activities, including recording decisions made by approvers under FMA reg 9

— supporting grant-giving activities with appropriate financial and performance monitoring frameworks.

Probity and transparency

The CGGs provide that probity and transparency are achieved in the context of grants by ensuring:

— that decisions are impartial, appropriately documented and publicly defensible as per Ch 3 of the CGGs

— compliance with the public reporting requirements as per Ch 4 of the CGGs

— that agency grants administration incorporates appropriate safeguards against fraud and other inappropriate conduct on the part of agency staff and grant recipients.

Achieving value with public money

Agencies should undertake a careful assessment of the costs, benefits, options and risks associated with a grant-giving activity to ensure that value is achieved. A grant should add value by achieving something worthwhile that would not occur without grant assistance.

Other legal and policy requirements

In addition to compliance with the CGGs, there are other legal and policy requirements that agencies need to take into account in relation to grants administration. An outline of some of these is set out below.

Constitutional issues

In planning for a new grants program, or reviewing an existing program, consideration should be given to the Commonwealth's constitutional power to make the payments under the program. The Attorney-General's Department can provide assistance with this process, and advice on constitutional issues can be obtained, if necessary, from AGS.

FMA Act and Regulations apply to grants

No matter what type of grant is being considered, for FMA Act agencies the FMA Act provides a framework for the proper management of public money and public property (the term 'public money' is defined to mean, among other things, money in the custody or under the control of the Commonwealth: FMA Act, s 5). Additional detailed procedures for the management of public money are contained in the FMA Regulations made under the FMA Act. Grants can also be affected by each agency's Chief Executive's Instructions.

Detailed procedures for the management of public money are contained in the FMA Regulations ...

The regulations referred to below apply to spending proposals. A 'spending proposal' means a proposal that could lead to entering into an 'arrangement'. An arrangement means an arrangement, including a contract or agreement under which public money is payable or may become payable (FMA reg 3).

FMA reg 8

FMA reg 8 provides:

> 8 Entering into an arrangement
>
> A person must not enter into an arrangement unless:
>
> (a) a spending proposal has been approved under regulation 9; and
>
> (b) if required, written agreement has been given under regulation 10.

FMA reg 8 applies to grants and accordingly reg 9 approval and if required, reg 10 agreement, must be obtained prior to entering into the arrangement. FMA reg 10 agreement does not have to be given before the proposal is approved under FMA reg 9.

FMA reg 9

FMA reg 9 provides:

> An approver must not approve a spending proposal unless the approver is satisfied, after making reasonable inquiries, that giving effect to the spending proposal would be a proper use of Commonwealth resources (within the meaning given by subsection 44 (3) of the Act).

'Proper use' means efficient, effective and ethical use that is not inconsistent with the policies of the Commonwealth (FMA Act, s 44(3)). Accordingly, in approving a spending proposal, the approver must be satisfied that giving effect to the spending proposal will be an efficient, effective and ethical use of Commonwealth resources. Relevant issues to consider might be the selection of the project/recipient and the terms of the funding agreement. Both of these are discussed further below.

The approver must also be satisfied that the spending proposal is not inconsistent with the policies of the Commonwealth. These policies will vary depending on the nature of the spending proposal. Approvers should make

reasonable inquiries to ensure they comply with relevant policies. A number of general policies can have application to grants programs. For example, if a project involves construction works then the terms of that funding may need to include a requirement that the recipient comply with the National Code of Practice for the Construction Industry in order to comply with the Australian Government Implementation Guidelines for the National Code of Practice for the Construction Industry. In addition, the terms of the funding may also need to include a requirement that the recipient comply with the Occupational Health and Safety Accreditation Scheme. For the purpose of a granting activity, the relevant Commonwealth policies will also include any program guidelines for that granting activity.

An 'approver' for the purposes of the FMA Regulations is a minister, a chief executive or a person authorised by or under an Act to exercise a function of approving proposals to spend public money (FMA reg 3).

FMA reg 10

Where a funding agreement provides for any funding payments to be made by an FMA Act agency and the agency has an insufficient appropriation of money under the provisions of an existing law (or an appropriation in a Bill before parliament) then the agency must not enter into the funding agreement unless the Finance Minister has agreed, in writing, to the expenditure that might become payable under the funding agreement. This will occur for example, where a multi-year grant is made from an annual administered appropriation.

While it is unusual, funding agreements occasionally include indemnities between the parties. If this is the case, FMA reg 10 agreement may be required in respect of the contingent liability created by the indemnity, unless FMA reg 10A applies – see the AGS legal briefing on indemnities for more information on this.

The Finance Minister has delegated his powers under FMA reg 10 to Chief Executives with certain directions. It is important to check whether the agency holds a delegation under FMA reg 10 and whether the delegation extends to the proposed expenditure. If it does it will not be necessary to refer the matter to the Finance Minister for agreement.

FMA reg 12

FMA reg 12 provides that, if approval of a spending proposal has not been given in writing, the approver must record the terms of the approval in writing as soon as practicable after giving the approval. In addition to this general requirement in relation to spending proposals, for grants, the approver must include in the record the basis on which the approver is satisfied that the spending proposal complies with FMA reg 9.

FMA section 12 and public money

If the nature of an arrangement is one where the funding recipient will be handling public money on behalf of the agency, (because the agency will exercise a high level of control over the money paid to the funding recipient) the agency will need to obtain authorisation from the Finance Minister under section 12 of the FMA Act prior to entering the arrangement. Alternatively, the agency will need to be aware that the recipient may become an 'official' and need to comply with the FMA Act and Regulations in respect of their handling of the money.

Are any other approvals required?
Some funding agreements may also require an agency to obtain additional approvals. For example, approval under the *Lands Acquisition Act 1989* (LAA) may be required if some or all of a grant will be spent on acquiring or upgrading land, buildings or fixtures and the terms and conditions of the funding agreement give the Commonwealth rights in relation to those assets that amount to an 'interest in land' under section 6 of the LAA .

Risk management[2]
The CGGs emphasise that risk management should begin at the planning and design phase of the grant and continue throughout the process through to the completion of the funded project and review and evaluation of the grant. The CGGs include a list of examples of risks specific to granting activity that should be considered. Consideration of such risks prior to the establishment of the granting activity will assist the agency to achieve efficient, effective and ethical grants administration.

Risk management should begin at the planning and design phase ...

Establishing the grant relationship

Compliance with Commonwealth Grant Guidelines and FMA requirements

Most of the CGG and FMA Act requirements go directly to establishing the grant relationship. This section provides some further discussion on issues that agencies should consider in establishing grants programs and selecting recipients.

Is the arrangement a procurement or a grant?

One of the very first issues that many agencies need to consider is whether the proposed spending proposal is a grant or a procurement. As referred to previously in this briefing, a 'grant' is defined in FMA reg 3A and what constitutes a grant is discussed in more detail in Finance Circular 2009/03: *Grants and other common financial arrangements*. 'Procurement' is defined in the Commonwealth Procurement Guidelines. However, in some cases, the distinction between a grant and a procurement may not be immediately obvious. In those cases it is necessary to look at the wider picture, including the purpose for which the funds are to be provided, and the source of the funds, to determine the true nature of the transaction.

In some cases, where services are being provided, the identity of the recipient or beneficiary of the services (e.g. whether it is the Commonwealth or the community more broadly) might also be a relevant consideration. As a rule of thumb, if the major focus is acquiring property or services for a payment, it should generally be treated as procurement. This includes property or services provided to a person on behalf of the Commonwealth. However, if the prime focus is the enabling of an activity which also promotes government policy objectives, it can generally be treated as grant funding.

In many cases, agencies have some discretion as to how they achieve their policy objectives and, in some cases, similar objectives may be achieved through either a procurement or grant. Agencies should give early and careful consideration to which approach they propose to take because the legal and policy requirements, particularly as to the process for selecting the other party, are quite different for procurements and grants.

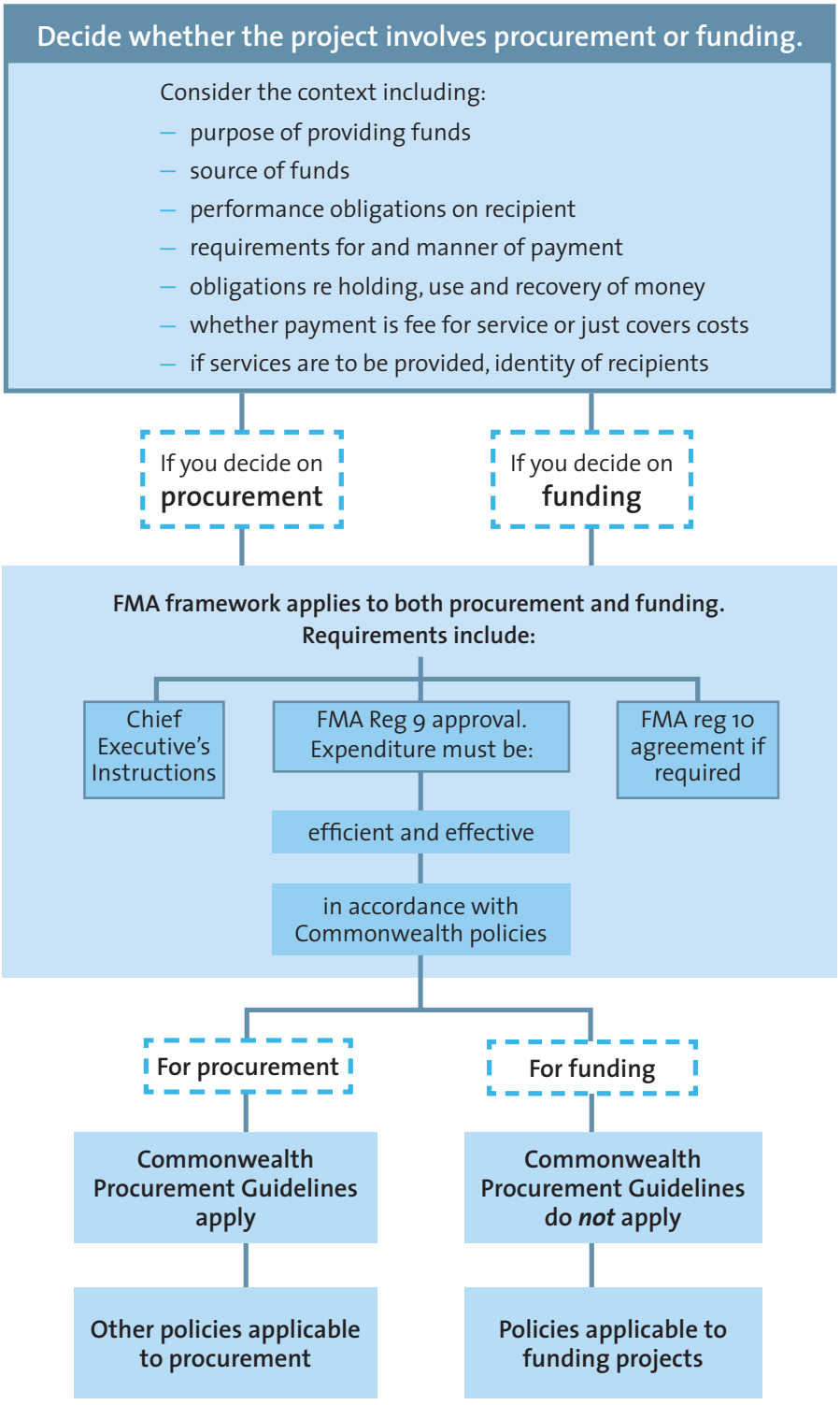
The legal and policy requirements ... are quite different for procurements and grants.

Finance Circular No. 2009/03: *Grants and other common financial arrangements* provides guidance on how to distinguish a grant from other common types of financial arrangements. Agencies should consult with the Department of Finance and Deregulation where it is unclear how to characterise a particular financial arrangement. Legal advice can sometimes assist in determining which approach will best meet the agency's objectives. This could be particularly appropriate if the arrangements are relatively novel or complex.

Selecting grant recipients

The method of selecting grant recipients may differ depending on the nature of the grant program. For example, some grant programs may not involve a competitive selection process, whereas others will require careful attention to the selection process where it is intended that applicants 'compete' for funding.

Overview of the FMA Act framework



The selection process

An agency's principal consideration when selecting grant recipients should be to use Commonwealth funds in a way that is an efficient, effective and ethical use of Commonwealth resources. In particular, in accordance with the CGGs, agencies should aim to achieve value with public money. The CGGs provide that, unless specifically agreed otherwise, competitive, merit-based selection processes should be used for selecting grant recipients, based upon clearly defined selection criteria. Where an agency uses a competitive process for the provision of a grant, an appropriate process should be chosen for selecting the grant recipients, having regard to the size and risk profile of the grant program, the likely number and type of applicants, and the program's objectives and desired outcomes.

An appropriate process should be chosen for selecting the grant recipients, having regard to the size and risk profile of the grant program, the likely number and type of applicants, and the program's objectives and desired outcomes.

It may be appropriate to conduct a targeted and restricted selection process for a specific project where the agency has determined that only a small number of organisations are capable of undertaking the project. A direct or restricted selection process may be appropriate, for instance, where the project to be funded is extremely specialised or needs to be conducted in a remote geographic region.

Generally, however, if a competitive process is to be undertaken, it is prudent to conduct an open process, as such processes are more likely to identify all interested applicants and avoid allegations of potential unfairness or inadvertent bias. However, in each case the agency should determine whether the lower risk involved in conducting an open grant application process will outweigh the additional time and cost that might be required for an open selection process.

Where a competitive selection process is run, agencies should ensure that they follow appropriate probity principles (e.g. by complying with program guidelines and following evaluation criteria determined prior to receipt of applications) to lessen the risk of an unsuccessful applicant making a claim against the agency in relation to the conduct of the process. It may be appropriate to have a probity adviser involved in these competitive selection processes. Further, to avoid confusion, references to procurement terminology such as 'request for tender' should not generally be used in grant documentation.

Program guidelines

It is a mandatory requirement under the CGGs for agencies to develop grant guidelines for new grant programs and to make them publicly available (including on agency websites) where eligible persons and/or entities are able to apply for a grant under a program. Publishing the guidelines for a grant program on the relevant agency's website, and advertising those guidelines widely, can also assist the agency to maximise the number of suitable grant applications it receives.

Extensive mandatory requirements can sometimes unintentionally exclude suitable applicants from the process.

The guidelines must be in accordance with the CGGs. The content of the guidelines will vary depending on the size, scope and nature of the grant program. For example, the guidelines should state the purpose and scope of the program, any mandatory requirements for the grant, and the criteria against which the agency will assess all grant applications, and also provide a copy of the funding agreement for the program.

Agencies should carefully consider what, if any, requirements will be mandatory in their funding processes. The inclusion of extensive mandatory requirements can sometimes unintentionally exclude suitable applicants from the process.

Recipients' capacity to enter into funding agreements

It is usually preferable to enter into a funding agreement with individuals, incorporated entities (e.g. companies, incorporated associations or Indigenous corporations, bodies corporate established under legislation) or governments. Particular risks are involved where an agency enters into a funding agreement with an unincorporated association or unincorporated joint venture (sometimes called a consortium) as these types of entities do not have the capacity to enter into contracts (or even accept conditional gifts) as a separate entity. As a result, any funding agreement entered into with an unincorporated association or joint venture may be unenforceable, or only enforceable against the individual who signed the agreement. Implications from this can include significantly limiting the agency's ability to recover funds under the agreement, although the extent to which this is a significant consideration will be a matter for assessment on a case-by-case basis.

Particular risks are involved where an agency enters into a funding agreement with an unincorporated association or unincorporated joint venture ...

If an agency receives a grant application from an unincorporated association, it should consider making the incorporation of the association (under one of the State or Territory Associations Incorporation Acts or the Commonwealth's Indigenous corporations legislation) a precondition to entering into a funding agreement. Incorporation under such legislation is a relatively quick, inexpensive and straightforward process, and agencies that regularly provide funds to unincorporated associations may wish to consider establishing a program to encourage those associations to incorporate (subject to those organisations obtaining their own legal advice about the process and implications).

Where the applicant is a joint venture, agencies may need to consider strategies such as entering into the funding agreement with a lead member of the venture with the legal capacity to enter into contracts. It may also be prudent for agencies to require satisfactory evidence of the relationship between the venturers and their individual legal commitments to the project. Similarly, if moneys are being paid to a subsidiary, it may be important to establish the relationship between the parent company and the subsidiary. It is sometimes appropriate to obtain parent company guarantees.

Recipient and project risks

Sometimes problems will arise with a particular grantee's ability to finish a project. Agencies can seek to minimise the risk of spending Commonwealth funds on incomplete or potentially failed projects by asking the following types of questions when evaluating applications and conducting the risk assessment in accordance with the CGGs:

- Is the project too ambitious?
- Is the total amount of project funding less than the amount which the agency might consider necessary to complete the project? If so, is there satisfactory evidence of funding from other sources to enable the project to be completed?
- Is the applicant financially viable?
- Does the project rely on a large number of participants co-operating with the applicant? If so, have these participants made legal or other reliable commitments to the project? (If the recipient intends to subcontract the vast majority of the funded project, it may be better for the agency to directly fund the proposed subcontractor instead.)
- What experience does the applicant have in performing these types of projects?

Finally, because of the range of risks involved, agencies should avoid paying funds to a recipient before the recipient has signed the funding agreement.

The funding agreement and managing the grant relationship

The funding agreement

In this briefing we use the term 'funding agreement' to describe the document which records the terms and conditions on which the grant is provided.

The funding agreement sets out the relationship between the agency and the recipient. Unless legislation sets out the terms on which the grant can or must be provided, agencies generally have a discretion as to the form of the funding agreement. The CGGs provide that an enforceable agreement should be established wherever possible.

A funding agreement must be consistent with the terms of the approval of the spending proposal given under FMA reg 9, including any conditions on the approval (CGGs, para 3.11).

In addition, the key principles contained in the CGGs relating to proportionality, outcomes, collaboration and partnership, and governance and accountability have particular relevance in determining what provisions to include in the funding agreement.

Agencies should avoid paying funds to a recipient before the recipient has signed the funding agreement.

The form of funding agreement

The forms of enforceable funding agreement include: a deed, a contract, conditional gift and an exchange of letters.

If the document is drafted so as to take the form of a conditional gift, it is essentially a grant of money or property subject to conditions. Those conditions may be either precedent or subsequent. If a condition precedent is not fulfilled then typically the gift does not take effect and the gift, whether money or property, does not pass to the grantee. If a condition subsequent is not fulfilled then typically the grantee loses the gift and the property reverts to the grantor or, in the case of money, a right of action to recover a similar amount arises. Although these conditions might be recorded in an agreement under which the grantee agrees to accept the conditional gift, it is not usually enforceable under the law of contract. This is due, primarily, to an absence of mutual consideration, which is typically required for the formation of a contract.

More recently, many agencies have sought to impose a range of enforceable conditions in connection with grants. Accordingly, funding agreements are now often expressed to be contracts or deeds, with the intention that all of the obligations be enforceable.

Ultimately, the rights and obligations of the Commonwealth and a funding recipient, and the extent to which those rights and obligations are enforceable, will primarily depend on the terms of the grant documentation itself. This means that it is important for agencies to consider what rights and obligations they require in developing their grant documentation for a particular project or activity.

It is important for agencies to consider what rights and obligations they require ...

Identity of the recipient may influence the terms and conditions

The decision as to what funding mechanism will be used and what terms and conditions might be appropriate will be influenced by various factors including the identity of the recipient, the type of obligations the government is seeking to impose on the recipient, and the remedies that the agency wishes to have in the event of non-compliance. As examples:

— Grants to community groups often take the form of contracts, many of which follow a standard form.

— Indigenous program grants often use the suite of Indigenous funding agreements developed by the Department of Families, Housing, Community Services and Indigenous Affairs

— Grants to States and Territories that are covered by the *Federal Financial Relations Act 2009* may be required to take the form of a National Agreement or National Partnership Agreement. These are not subject to the CGGs.

— Grants under commercial, industrial or research and development programs, particularly where significant amounts are involved, are more likely to take the form of individually negotiated contracts which may involve third parties such as banks.

Community grants

The use of standard forms of funding agreement (where consistent policy positions are taken) by agencies for use in providing grants to community organisations facilitates whole-of-government funding and can greatly simplify the funding process for the agency or agencies involved. It can also help make administration of projects easier, as agencies have a consistent position on the relevant issues. From the grant recipient's perspective, the use of agreements by government agencies where consistent positions are taken can be less confusing, and it helps to reduce administrative and compliance costs. However, there is a limit to which standardisation can and should be taken, and agencies should consider the most appropriate agreement for the community grant program which they are considering.

Grants to States

Section 96 of the Constitution provides that the Commonwealth Parliament 'may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit'. This means that the parliament can legislate to provide for financial assistance to States (and Territories, under s 122 of the Constitution) and can impose conditions of its choosing on that financial assistance.

Payments to a State or Territory made under the Federal Financial Relations Act (including National Specific Purpose Payments and National Partnership Payments) are not grants for the purposes of the FMA Regulations, and are not subject to the CGGs. Such payments are subject to the Federal Financial Relations framework, which implements the Intergovernmental Agreement on Federal Financial Relations. In accordance with the framework, such payments must generally be made under the terms of a National Agreement or a National Partnership Agreement (as applicable). If an agency is uncertain whether the framework applies to a particular payment to a State or Territory then they should seek clarification from the Department of the Treasury.

Payments ... under the Federal Financial Relations Act ... are not grants for the purposes of the FMA Regulations.

Some grants to States and Territories fall outside the Federal Financial Relations framework (e.g. because they are awarded as a result of a competitive funding process that is open to a range of organisations, not just State agencies) and may be subject to the CGGs. In any case involving a grant to a State or Territory, careful consideration is required as to whether accountability mechanisms typically contained in funding documentation with private or non-profit sector organisations are appropriate. Where a State or Territory is taking on a management role for a third party project, funding agencies should also consider the provisions necessary to cover obligations and risks associated with that role.

Industry development grant programs

In contrast to community grant programs, significant one-off industry grant-giving activities are less amenable to standard funding agreements, and any standard agreement is more likely to require tailoring to individual projects.

Typically, some of the key issues in these types of agreements will be:

— which corporate entity within a corporate group, or which entity within an unincorporated joint venture, will be funded, and what its relationship is with the group more generally

— timing of and conditions for each milestone payment

— implications of failure to meet milestones or project insolvency

— intellectual property issues, particularly where the project is of a trial or 'demonstration' nature

— relationship between government funding, private equity and private debt that may be involved in the project.

Increasingly, there are also situations where consortiums involving State, local government and industry are funded. In these cases, issues include how the agreement should be structured, the level of control and responsibility the lead proponent is willing to take for the activity which is being funded, the extent to which individual consortium members should also be required to comply with terms equivalent to those in the funding agreement and the extent to which individual consortium members should be required to report on their use of the funding.

Constitutional issues can arise where grants are made to the States, particularly where this is outside the Federal Financial Relations framework. Constitutional advice should be sought in relation to such grants.

Mechanisms to safeguard public money

Mechanisms to safeguard public money include providing grant payments progressively as milestones are reached, and performance monitoring and financial reporting (including through the provision of regular reports on funded activities and the acquittal of grant funds).

Mechanisms in projects presenting greater risk may include:

— taking security over assets

— having organisations related to or associated with the recipient provide financial and/or performance guarantees.

The extent of the safeguard measures will depend on the amount of money ... identified risks ... and the broader policy considerations ...

The extent of the safeguard measures will depend on the amount of money provided, any identified risks that it may not be used for the purposes for which it has been provided, and the broader policy considerations associated with the grant program.

Management of funds

Where the financial situation of the recipient permits, it is often prudent to structure the grant so that money is paid in instalments and/or in arrears on satisfactory completion of major project milestones. Each milestone might include a requirement for the recipient to provide a progress report to the agency. Money can also be paid on the recipient's satisfactory completion of the project and after the recipient has provided a satisfactory final report (the proportion of funds that might be paid at the end may vary significantly from project to project). In community grant programs, a small portion (e.g. 5%) might be payable on completion, whereas with larger-scale industry grant programs the amount might be quite large.

Such a payment structure can help encourage the recipient to provide the project reports and thereby assist the agency to meet its accountability and reporting requirements. However, a further report may still be required to acquit the final payment unless other arrangements are made to deal with acquittal of the final payment. Also, in circumstances where the risks are greater (e.g. because a new entity has been established specifically for the purposes of undertaking the project being funded), more regular reporting at the beginning of the project may be required to help ensure that any problems in delivery of the project and management of the funding are identified early.

Regular reporting at the beginning of the project may be required to help ensure that any problems in delivery of the project and management of the funding are identified early

By way of example, agencies often take the following positions in grant documentation. These may or may not be appropriate to a particular agency/project/grant recipient:

- The recipient is required to spend funds only on the project (and in accordance with the project budget, if one is specified).
- The recipient is required to obtain the agency's written approval before using the funds to acquire or create any assets that cost more than a specified amount unless those assets are specified in the agreement.
- At the end of a project, the agency has the right to recover a proportion of the residual value in project assets acquired with the funds. This helps prevent a recipient obtaining, for example, an unintended windfall gain when it uses the funds to acquire or create assets and those assets have not fully depreciated over the life of the project.
- The agency may withhold or suspend funds until the recipient performs its obligations under the agreement.
- The agency may withhold or suspend funds to the extent that the recipient has unspent funds or funds that have not been properly acquitted including under any other Commonwealth grant arrangement.
- The agency, the Auditor-General and the Privacy Commissioner have the right to access a recipient's premises, accounts, records and assets, for example, to ascertain the recipient's use of the funds for the project. Without this clause, the Australian National Audit Office (ANAO) would not necessarily have such a right.
- Where a grant recipient spends funds in a manner that is not expressly or impliedly permitted, the agency may:
  - require the recipient to repay an amount equal to the misspent funds (with interest if the amount is not paid by the due date)
  - offset the misspent amount against future payments of funds

  or
  - require the recipient to otherwise deal with the misspent amount as directed by the agency.

Agencies need to be cautious, however, about imposing high levels of control over the money they pay to grant recipients. Where an agency exercises a high level of control over money paid to grant recipients, there is a risk that the money will be 'public money' for FMA Act purposes. This risk is particularly strong where the grant recipient will be required to distribute funds to other persons on behalf of the agency. Agencies considering this kind of arrangement should consult with the Department of Finance and Deregulation.

In addition to the principles set out in the CGGs, the ANAO's *Implementing Better Practice Grants Administration* (June 2010) is a reference point that is designed to assist decision-makers and administering agencies to implement grants policies with a focus on processes to award grants.

If an agency is unsure of its rights in a particular case, including the right to recover, withhold or suspend funds, the agency should seek legal advice to determine what rights the Commonwealth has and the agency's options in exercising those rights.

Security for the performance of grant obligations[3]

One way to manage the relationship between the parties and to safeguard public money is for the agency to obtain security from the recipient for the performance of the recipient's obligations. For example, in more complex, sensitive or high-cost matters, it may be prudent to ask the recipient to give the agency a mortgage or charge over property owned by the recipient (such as over property acquired with the funds) as security for the performance of the recipient's obligations.

The advantages of the agency having security, particularly registered security, are that it can give the agency the ability to exercise power of sale in the event that the recipient defaults, and to improve rights to recover the funds advanced to the recipient. In the case of registered security, it helps give the agency priority over unsecured creditors and subsequent secured creditors, and may prevent unauthorised dealings with the secured property by the grant recipient or third parties.

Registered security ... may prevent unauthorised dealings ...

It is important to consider the nature of the property over which the security is proposed. Security over certain types of property may raise specific legal or policy considerations. For example, if the security relates to shares or other types of investment instruments, the granting of the security or its enforcement may result in the agency acquiring an interest in the shares or investment instruments. The Department of Finance and Deregulation has issued *Governance Arrangements for Australian Government Bodies*, which sets out policies in relation to ownership of shares and governance arrangements for bodies. Agencies should consult the Department before taking security over shares or investment instruments.

Whether it is appropriate for the agency to seek security will depend on the ability and willingness of the recipient to grant security to the agency, the value of the security available, the purpose of the grant and any applicable policy considerations. When the agency is considering whether to include the provision of security as a condition of the grant, it should confirm the legal capacity of the recipient to grant the security, and whether the property to be secured is sufficiently valuable for the purposes of securing the performance of the recipient's obligations.

Where the recipient is also receiving funding from other sources, including financial institutions in particular, it will be important to establish the priority of securities to be taken by the various funding parties (e.g. who will hold the first-ranking security).

Performance guarantee

Where a grant is provided to companies or other entities which are owned or controlled by a larger entity, consideration should be given to the provision of a guarantee for the performance of the grant recipient's obligations in the funding agreement. In the event the grant recipient fails to meet its obligations, the entity which provides the guarantee might be required to perform those

obligations on behalf of the grant recipient, including any obligation to repay the grant. The guarantee can be provided in the funding agreement or in a separate agreement between the guarantor and the agency. Again, this is a potentially complex area that requires legal advice and would only be relevant for more complex, risky or high-cost matters.

Trusts

From time to time agencies consider using trusts as a mechanism to safeguard public money in the event of insolvency. There are a number of legal and policy issues that need to be considered in these cases and specific advice should be sought.

Documentation

Reporting

To meet Commonwealth accountability requirements, agencies will usually need to actively monitor the grant relationship, especially the recipient's use of grant funds. For example, agencies will typically require that a grant recipient provide the following reports to the agency:

— progress reports regarding the performance of the project and the recipient's compliance with its obligations

— financial reports demonstrating that the recipient's use of the project funds are in accordance with the requirements: these reports are typically required at least annually and on completion of the project

— other reports as and when required by the agency.

In a more complex project, the reporting may take a more complex form including requiring accounting and expert reports for each milestone payment. The agency may require the ability to verify or validate the contents of such reports, including the ability to inspect the recipient's records and to access the recipient's premises to determine how the grant has been applied.

In a more complex project, the reporting may take a more complex form ...

Agency records

For the reasons outlined below, agencies should also maintain detailed records on each project. These records should include comments on the recipient's reports, performance of the project and compliance with the grant requirements. The records should also document any action taken by the agency and any variations agreed between the parties (noting, as set out below, that there may be inadvertent, unintended variations made by a party's conduct).

Such documentation can help agencies:

— meet their reporting and accountability obligations

— retain corporate knowledge regarding the recipient, project or funding agreement

— provide a reference point when negotiating new funding or varying existing arrangements.

Variations

The mechanism for variations needs to be considered for all grant projects. In some cases, where it is agreed to by a recipient, the Commonwealth may seek a right to vary some aspects of the grant arrangements unilaterally. For example, the Commonwealth might seek the unilateral right to vary the terms to:

— alter the due date for a payment of funds if the recipient has unspent funds or has not met a project milestone that is a prerequisite for a payment of funds

— extend the term or reduce the scope of the project (and the amount of grant) if the project is seriously delayed.

More commonly, however, an agency and a grant recipient will mutually agree to vary the agreement to take account of changed circumstances regarding the recipient or the project. Typically, funding agreements will require that any variation must be put in writing and signed by the parties' authorised representatives. However, notwithstanding this clause, a funding agreement can inadvertently be varied by other means. Agency officials should therefore be careful not to make statements (orally, or in correspondence, including in emails) to recipients that are inconsistent with the agency's rights in the agreement, since an inconsistent statement may vary the agreement, prevent (or 'estop') the Commonwealth relying on the terms of the agreement, or constitute a waiver of its legal rights under the agreement.

Common clauses in funding agreements

Community funding agreements

As a result of the development of standard funding agreements by many agencies, consistent positions on key policy issues have been reached between a number of agencies for similar types of community grant programs. These positions do not inhibit the flexibility of agencies to change the agreements to suit particular programs.

As an illustration, many agencies have adopted the following positions as an appropriate risk balance in community grant programs:

— Funds are required to go into a separate account of the recipient established solely for this purpose and separate from its other operational accounts. Alternatively, the recipient is required to ensure that the receipt and expenditure of the funds is clearly identified separately within the recipient's accounting records so that at all times the funds are identifiable and ascertainable.

— Once approval is given to use the funds to acquire an asset, the asset will be owned by the recipient (unless it is leased) and subject to use only by the recipient for the funded activity. There is also often a mechanism to prevent a recipient from making a windfall gain on an asset during the term of the agreement or when the agreement expires or is terminated.

— There is provision for regular reporting during the term of the agreement, and at the completion of the activity, on both the performance of the activity and expenditure of the funds with milestone payments linked to the receipt of acceptable reports.

— Intellectual property created with the grant is owned by the recipient, who gives a licence for its use to the agency where the agency sees a benefit in this occurring.

— There is no undertaking that any information concerning the recipient, or the terms of the agreement, will be treated as confidential. This is consistent with the guidance contained in *Guidance on Confidentiality in Procurement*, Financial Management Guidance No. 3 (Department of Finance and Deregulation, July 2007, available through <www.finance.gov.au>), which recommends that a starting point of disclosure should apply to contractual provisions (and related matters) and that any information should be examined to see if it is really confidential in nature.

All types of agreements

Regardless of the type of recipient, the following issues also need to be considered:

- the arrangements for monitoring the recipient's use of the grant and mechanisms for repayment, including interest (where appropriate), where the grant has not been applied for the agreed purposes
- which party is to bear any taxes that may apply to the grant transaction and, in particular, if any GST issues arise, how they are to be dealt with. The main GST issues involve whether any taxable supply is made in return for the grant, and/or whether the grant is denied the status of 'consideration' for GST purposes because it is made to a 'government related entity' and payments are 'specifically covered by an appropriation under an Australian law'. Agencies should consult applicable public rulings on the ATO website, the main ones being GSTR 2000/11 (grants) (currently under review), GSTR 2006/9 (supplies), and GSTR 2006/11 (payments under appropriations). A range of recent court and tribunal decisions may also affect GST outcomes (for example *TT-Line Co Pty Ltd v FCT* [2009] FCAFC 178 and *FCT v Department of Transport* [2010] FCAFC 84)
- where another grant may be provided to the recipient by another government agency or a third party for the same or similar purpose as the grant that is provided to the recipient by the agency, whether there should be an obligation on the recipient to report on the provision of such funding
- where the recipients' use of the grant generates income, such as interest from investment, whether there should be an obligation on the recipient to report on, or conditions on the use of, that income
- if the grant is payable on the achievement of milestones, the consequences of a recipient failing to achieve the milestone will generally benefit from being addressed in specific terms. In certain circumstances, for example where there is an element of uncertainty as to the ability of the recipient to achieve a milestone by the specified date, the provision of mechanisms to vary the milestone date, if such circumstances arise, may be appropriate
- in some cases, it will be appropriate to include warranties from the recipient about itself and the project in the funding agreement.

Ending the agreement

In the ordinary course of events, a funding agreement expires on the completion date set out in the agreement or once the grant recipient has completed the funded activity, submitted all of the required reports and returned any unspent funds. However, in some circumstances, it may become necessary (or desirable) for the agreement to be terminated early. An agency contemplating terminating a funding agreement needs to carefully consider any alternatives to, and possible consequences of, deciding to terminate the agreement, and seek legal advice on the proposed termination. This advice may need to cover issues such as using dispute resolution solutions before resorting to litigation. The advice may also need to consider the *Legal Services Directions 2005* (made under the *Judiciary Act 1903*).

Is it necessary to terminate the agreement?

An agency might consider terminating a funding agreement for a range of different reasons including because:

- the grant recipient has not met relevant milestones
- the grant recipient has not met other key requirements
- there has been a change in government policy on the program to which the grant relates, to such a degree that termination is necessary.

An agency might consider terminating a funding agreement for a range of different reasons ...

Options for termination

The agency's rights to terminate the agreement will usually be set out in the agreement. There may also be some common law rights, but it is preferable for termination provisions to be explicitly set out in the agreement. A funding agreement may be terminated in the following ways depending on the circumstances and the terms of the agreement:

— termination with compensation (or 'termination for convenience')

— termination for default

— termination by mutual agreement.

Termination with compensation

Termination with compensation (otherwise called 'termination for convenience') is a right related to the doctrine of executive necessity. This doctrine encompasses the principle that agreements and promises cannot be enforced on public interest grounds to the extent that they limit the ability of a minister or other officeholder to exercise their statutory or executive discretions or powers. Many funding agreements include such clauses. While the wording of termination for convenience clauses may suggest this right can be exercised at will by an agency, this may not always be the case, and the practical use of this clause may be more limited. For more details on termination for convenience clauses, see AGS Commercial notes No. 27, *Termination for convenience* (3 June 2008) at <www.ags.gov.au/publications/index.htm>.

Termination for default

A wide range of events may permit an agency to terminate a funding agreement for default by the recipient depending on the terms of the agreement. It is common for specific events of default to be contained in a funding agreement (e.g. the recipient's company winds up or it is subsequently found that the original grant application was based on false information). Other acts or omissions by the recipient may also constitute default through the recipient's failure to perform obligations under the agreement (e.g. failure to meet performance or reporting standards or not using the grant in accordance with the budget).

Where an agency identifies a breach that is not specifically described as an event of default under the funding agreement, a judgment needs to be made as to whether the breach is of a nature that justifies termination for default. For example, if the recipient breaches the agreement in a relatively minor way, it may be appropriate to withhold payment until the breach is remedied rather than terminate. The agency will usually exhaust all other options (such as providing the grant recipient with an opportunity to rectify the default) before terminating. Where an agency decides to terminate for default it must comply with any procedures set out in the funding agreement relating to the exercise of the right to terminate for default.

Wrongful termination

Agencies should take care in exercising either of the termination rights described above. If an agency wrongfully terminates an agreement this could amount to a repudiation of the contract, so legal advice is important to help avoid this situation. Also, if a wrongful termination occurs, the agency could be liable to pay damages to the recipient.

Termination by agreement
Of course, in some cases, the agency and the recipient may simply agree to terminate the agreement, although that would typically involve some consideration of the appropriateness of this course and the implications for any payments made by the Commonwealth and any work or materials produced by the recipient under the agreement. A decision to terminate by agreement would be governed by the requirements of s 44 of the FMA Act that Commonwealth resources be managed efficiently, effectively and ethically, and not inconsistently with Commonwealth policy.

What happens after the agreement expires or is terminated?

Damages/compensation when agreement terminated
Prior to terminating for convenience, agencies need to consider whether compensation is required to be paid to the recipient and the amount of compensation that might be payable.

If an agreement is terminated for default, agencies need to consider whether to sue the recipient for damages or to recover costs, unspent or misspent funding, or the funded assets from the recipient.

Agencies will also need to consider how to deal with final acquittals and other reporting issues.

Final acquittals and reporting issues
Agencies commonly require grant recipients to provide final reports and to retain records for an appropriate period (sometimes linked to the *Corporations Act 2001*, which requires 'financial records' to be kept for seven years: s 286). It is also common for agencies to consider including in funding agreements a requirement for the grant recipient to provide a report to the agency within a certain period (e.g. 60 business days) of the completion of the project.

Agencies commonly require grant recipients to provide final reports and to retain records ...

Unspent and misspent funds

Rights under the funding agreement
Where any termination right is exercised, the funding agreement will normally provide the agency with the power to recover funds where those funds:

— are not legally committed for expenditure and payable by the date of termination

or

— have not been spent in accordance with the agreement.

Where this is the case, the funding agreement may provide that these funds are recoverable as a debt due to the Commonwealth without the requirement for further proof. Agencies should note, however, that if the required final regular report is not provided, or other reports have not been provided, it may be difficult to ascertain the amount actually owing. In this situation, the agency may need to ascertain, through dispute resolution or a court process, the amount actually owing.

Statutory responsibilities
Chief executives of FMA Act agencies are responsible under s 47 of the FMA Act for pursuing recovery of debts owing to their agency unless they are satisfied that the debt is not legally recoverable, it is not economical to pursue recovery of the debt, or it has been written off, as authorised by an Act. In the absence of a specific statutory power, in the majority of cases a chief executive cannot waive a debt—this power can generally only be exercised by the Finance Minister under s 34 of the FMA Act, or, where the Finance Minister has delegated that power, by certain officials within the Department of Finance and Deregulation.

Can an agency spend recovered funds?
In the event that funds are recovered from the recipient (including following termination of a funding agreement) there may be scope to allocate this money to another recipient or other agency activities.

Repayments to agencies are governed by s 30 of the FMA Act. An agency considering how best to deal with a repayment should involve its Chief Financial Officer, who, if necessary, can involve the Department of Finance and Deregulation.

Tips for agencies

In summary:

- Agencies must act in accordance with the CGGs in implementing grant programs.
- Agencies need to give careful consideration to what rights and responsibilities they wish to impose in relation to grant programs having regard to the identity of the recipient and the nature of the program—this will dictate what type of funding agreement is most appropriate.
- Grants require approvals under the FMA Regulations.
- It is important to have a defensible basis for selecting grant recipients. Where an open selection process is used, it should be based on predetermined selection criteria. A probity adviser can sometimes assist.
- The CGGs and the FMA Regulations include a number of reporting and accountability provisions that must be complied with in the grant-giving process and once a grant has been approved.
- For some grant programs, a standard form agreement may be appropriate but for others there may need to be tailoring of the terms and conditions.
- Agencies need to consider how best to achieve a proper use of Commonwealth resources when making a grant, including, where relevant, through the use of milestone payments and reporting arrangements.
- Care needs to be taken to avoid inadvertently amending funding agreements, particularly through verbal discussions and email exchanges.
- A decision to terminate a funding agreement needs careful consideration and, typically, should only occur based on legal advice .
- A number of Commonwealth laws may be relevant to grant recipients. AGS has prepared a fact sheet for grant recipients which is available on the AGS web site at <www.ags.gov.au/publications/agspubs/index.htm>.

This briefing was prepared by Leah West, Paul Lang and Kathryn Grimes with the assistance of Kathryn Graham and Sam Arnold. It is an update to Legal Briefing No. 83 *(and builds on the work of the authors of AGS Commercial notes No. 19 (29 May 2006)).*

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Notes

1 In relation to terms used in reg 3A, 'Public Money' is defined in s 5 of the FMA Act. A 'recipient' means a recipient that is external to the legal entity of the Commonwealth. Notional payments and receipts by agencies within the meaning of s 6 of the FMA Act are not grants. In an accounting sense, a 'grant' is a non-exchange transaction, as government does not directly receive approximately equal economic value directly in return.

2 See also AGS Legal Briefing No. 86, *Indemnities in Commonwealth Contracting* (12 January 2009) at <www.ags.gov.au/publications/index.htm>.

3 For more information on securities, see AGS Commercial Notes No. 33, *Securities: ensuring payment of debts to the Commonwealth* (9 November 2009) and AGS Commercial Notes No. 29, *Personal Property Securities Bill 2008: an overview of the new regime* (2 September 2008) at <www.ags.gov.au/publications/index.htm>.

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