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Legal briefing

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COMMONWEALTH GRANTS: AN OVERVIEW OF LEGAL ISSUES

What is a grant?

Granting activities can take a variety of forms. For example, a grant may be a one-off or ad hoc grant arrangement or it may form part of a broader grant program and/or competitive assessment process.

A 'grant' is defined in reg 3A of the *Financial Management and Accountability Regulations 1997* (FMA Regulations) 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

(b) which is intended to assist the recipient achieve its goals; and

(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.

Regulation 3A(2) of the FMA Regulations specifies what arrangements are not 'grants': for example, procurement, loans, investments, grants to States under s 96 of the Constitution, payments to States and Territories covered by the *Federal Financial Relations Act 2009* (FFR Act), and certain local government and education payments.

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

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This issue

Finance Circular 2009/03 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.

Is the arrangement a procurement or a grant or something else?

One of the first issues that many agencies need to consider is whether a proposed spending proposal is a grant or a procurement or something else. As referred to above, a 'grant' is defined in the FMA Regulations (see reg 3A). A 'procurement' is defined in the Commonwealth Procurement Rules. However, in some cases, the distinction between a grant and a procurement may not be immediately obvious despite consideration of these definitions. In those cases it is necessary to look at the wider picture, including the purpose for which the funds are to be provided, the nature of the activity and the source of the funds, to determine the true nature of the transaction.

In cases where services are being provided, the identity of the recipient or beneficiary of the services (eg 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 of the arrangement is on the provision of property or services (to the Commonwealth or a third party) in exchange for a payment by the Commonwealth, it should generally be treated as procurement. However, if the prime focus of the arrangement is to enable an activity that also promotes Government policy objectives, without requiring some direct return to the Government (other than, say, the provision of reports), it can generally be treated as grant funding provided it meets the definition in FMA reg 3A.

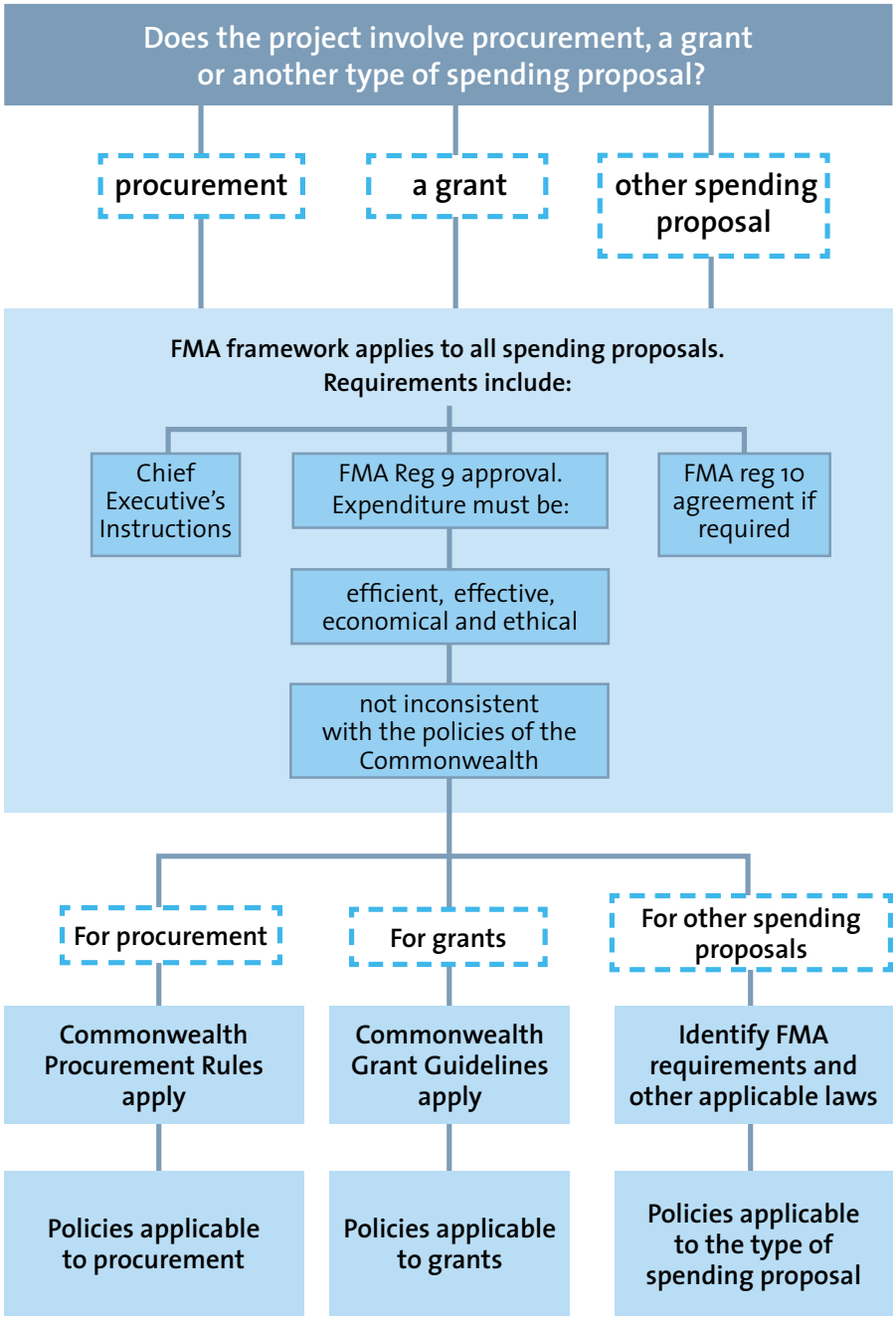
In some cases, agencies have some discretion as to how they achieve their policy objectives and similar objectives may be achieved through either a procurement or a grant. Agencies should give early and careful consideration to which approach they propose to take because the legal and policy requirements,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

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.

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

Payments 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. Section 96 payments to States, and payments to the States and Territories under the FFR Act, are not 'grants' for the purpose of the FMA Regulations. Such payments will also therefore not be 'grants' for the purposes of the CGGs.


Does the project involve procurement, a grant or another type of spending proposal?
procurement
a grant
other spending proposal
FMA framework applies to all spending proposals. Requirements include:
Chief Executive's Instructions
FMA Reg 9 approval. Expenditure must be:
FMA reg 10 agreement if required
efficient, effective, economical and ethical
not inconsistent with the policies of the Commonwealth
For procurement
For grants
For other spending proposals
Commonwealth Procurement Rules apply
Commonwealth Grant Guidelines apply
Identify FMA requirements and other applicable laws
Policies applicable to procurement
Policies applicable to grants
Policies applicable to the type of spending proposal

Payments to a State or Territory made under the FFR Act (including National Specific Purpose Payments and National Partnership Payments) are instead subject to the Federal Financial Relations framework (FFR framework). The FFR framework implements the Intergovernmental Agreement on Federal Financial Relations. In accordance with the framework, such payments must be made under the terms of a National Agreement, National Partnership Agreement, Project Agreement or Implementation Plan (as applicable).

Agencies are required to consider whether a proposed payment arrangement with a State or Territory is subject to the FFR framework or is a 'Commonwealth Own-Purpose Expense' (COPE). A COPE is not subject to the FFR framework but may in some cases be a 'grant' to which the CGGs apply. When considering this issue an agency should have regard to the guidance contained in Finance Circular 2010/02: *Classification of payments to the States and Territories and Commonwealth Own-Purpose Expenses*[1] and should consult the Department of Finance and Deregulation to verify the agency's classification of the payment arrangement as a payment under the FFR framework or a COPE.

Commonwealth legal framework for grants

FMA Act and Regulations apply to grants

No matter what type of grant is being considered, for agencies subject to the *Financial Management and Accountability Act 1997* (FMA Act), 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). However, most of the detailed procedures for the management of public money are contained in the FMA Regulations. Grants can also be affected by an agency's Chief Executive's Instructions made under the FMA Act.

Most grants require legislative authority.

Authority to make a payment

In planning for a new granting activity (including a new grant program), or reviewing an existing granting activity, consideration must be given to the Commonwealth's power to make the payments under the program, particularly in light of the decision in *Williams v Commonwealth* [2012] HCA 23; (2012) 86 ALJR 713 (*Williams*). The finding of the High Court in *Williams* suggests that most grants require legislative authority.

This means that, in most cases, one of the first issues that will need to be considered is the legislative authority to make payment under the grant agreement. This is additional to whether there is an available appropriation to support the granting activity.

Some grant programs are supported by specific legislation. Other granting activities are supported by the new s 32B of the FMA Act, which was enacted following the decision in *Williams*. Section 32B provides, in summary, that:

— if the Commonwealth does not otherwise have power to make, vary or administer an arrangement under which public money is, or may become, payable by the Commonwealth, or a grant of financial assistance (to a State or Territory or other person), and

— the arrangement or grant is covered by Sch 1AA to the FMA Regulations (either because it is specified in the Schedule or is included in a specified class of arrangements or grants or is for the purposes of a specified program)

then the Commonwealth has power to make and administer the arrangement or grant, subject to compliance with other laws.

A range of grants are now specified in Sch 1AA to the FMA Regulations for the purposes of s 32B of the FMA Act.

If a granting activity is not already supported by program-specific legislation or by s 32B of the FMA Act, it may be necessary to amend the FMA Regulations to include reference to the program. The Department of Finance and Deregulation is responsible for the FMA Regulations. Legal advice may be required.

A range of grant programs are now specified in Sch 1AA to the FMA Regulations...

Also, new s 44(1A) of the FMA Act provides a power for the Chief Executive of an FMA Act agency to manage the affairs of the agency, including the power to make and administer arrangements on behalf of the Commonwealth. This power is delegable by the Chief Executive.

Further, in *Williams*, the High Court indicated that, where spending is part of the ordinary and well-recognised functions of government, legislative authority (other than an appropriation) is not required.

The spending approval process

The FMA Regulations that relate to the approval of spending refer to 'spending proposals'. A 'spending proposal' is a proposal that could lead to entering into an arrangement (FMA reg 3). An 'arrangement' is defined broadly in FMA reg 3 and includes contracts and agreements under which public money may become payable. The FMA Regulations deal with the process for entering into arrangements in the following order:

— the overarching requirements on officials entering into arrangements (reg 8)
— the process for approval of a spending proposal (reg 9)
— the process for seeking agreement where there is insufficient available appropriation to cover amounts payable under the arrangement (reg 10/ reg 10A)
— the requirements for recording approvals (reg 12).

FMA reg 8

FMA reg 8 provides:

> 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. Accordingly, reg 9 approval and, if applicable, reg 10 agreement, must be obtained prior to entering into the arrangement.

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, economical 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, economical and ethical use of Commonwealth resources. Relevant issues to consider would include the process for selection of the project/recipient and the terms of the grant agreement. Both of these issues are discussed later in this briefing.

The approver must also be satisfied that the spending proposal is not inconsistent with the policies of the Commonwealth. The policies relevant to a particular spending proposal will vary depending on the nature of the spending proposal. In accordance with Finance Circular 2011/01: *Commitments to spend public money (FMA Regulations 7 to 12)*, the inquiries that the approver could reasonably be expected to make to satisfy themselves will depend on the nature and context of the spending proposal.

Examples of policies that may be relevant to grant activities include:

- Australian Industry Participation Plans for Commonwealth Government Grants (grants over $20 million or grant programs that provide for grants of over $20 million)
- 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
- Australian Government Building and Construction OHS Accreditation Scheme.

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 spending proposals (FMA reg 3). An agency's internal delegations will often determine who is an approver within that agency.

FMA reg 10

Arrangements that extend beyond the available appropriation

Grants provided under 'administered items' in an agency's appropriations will typically be made available for 1 financial year, as administered items are usually subject to a process to restrict them to expenses related only to the relevant financial year. Some grants are provided under appropriations that operate for longer periods (eg under special appropriations in specific legislation). A grant agreement that provides for any payments to be made by an FMA Act agency beyond the period for which there is an existing appropriation (or an appropriation in a Bill before Parliament) will require the written agreement of the Finance Minister or delegate under FMA reg 10. It is important to check whether the relevant official holds a delegation under FMA reg 10 and whether the delegation from the Finance Minister[2] extends to the proposed expenditure. If it does not, it would be necessary to refer the matter to the Finance Minister to seek agreement.

A funding agreement that provides for any payments to be made beyond the period of any appropriation … will require FMA Reg 10 agreement.

Indemnities or other contingent liabilities

If an arrangement contains a contingent liability (for example, an indemnity given by the Commonwealth) then it may be necessary to seek agreement under FMA reg 10 unless FMA reg 10A applies. For a detailed discussion on indemnities, contingent liabilities and relevant FMA approvals, see AGS Legal Briefing 93, *Indemnities in Commonwealth Contracting*, 19 August 2011.

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, 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.

Further practical guidance regarding the requirements in FMA regs 7–12 is contained in Finance Circular 2011/01: *Commitments to spend public money (FMA Regulations 7 to 12)*.

Commonwealth policy framework for grants

Commonwealth Grant Guidelines

The CGGs establish the policy framework for grants administration by FMA Act agencies. The CGGs are divided into 2 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 7 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.

An official performing duties in relation to grants administration must act in accordance with the CGGs.

The CGGs are issued by the Finance Minister under reg 7A of the FMA Regulations. FMA reg 7A(2) provides that an official performing duties in relation to grants administration must act in accordance with the CGGs. The CGGs do not apply to bodies subject to the *Commonwealth Authorities and Companies Act 1997* (CAC Act).[3]

In the CGGs, 'grants administration' includes planning and design, selection and decision-making, making a grant, managing grant 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.

Mandatory grant administration process requirements

Ministerial 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 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, including in a situation where the minister approves a grant that the relevant agency recommended be rejected, 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 that 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.

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). Each agency is required to publish on its website information about its individual grants no later than 7 working days after the grant agreement for the grant takes effect (the date of effect will depend on the particular arrangement itself – for example, it may be a specified commencement date or relate to a specified event) and retain that information on its website for 2 financial years.

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 grant agreement, the agency:

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

— must document the reasons for not reporting fully

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

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 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)[4]

— 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 (eg Chief Executive's Instructions) and the terms of applicable grant 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 to 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).

Risk management

The CGGs emphasise that risk management should begin at the planning and design phase of the grant and continue through to the completion of the funded project and review and evaluation of the grant. Consideration of such risks prior to the establishment of the granting activity will assist the agency to achieve efficient, effective, economical and ethical grants administration.

Key principles for good grant administration

Part 2 of the CGGs establishes 7 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 (including 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 grant 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 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.

Legal issues when establishing grant programs and other granting activities

Compliance with Commonwealth Grant Guidelines and FMA Act requirements

Most of the CGG and FMA Act requirements relate to establishing the grant. This section provides some further general discussion on issues that agencies should consider in establishing grants programs and selecting recipients. For a range of specific legal issues that may need to be worked through when setting up a new program, see AGS Fact Sheet Number 10, *Legal issues to consider for new programs*.

Identifying potential risks

The CGGs emphasise that risk management should begin at the planning and design phase. Taking the time at the beginning of a grant program to identify all the legal risks that might arise from the program and how they might be managed places an agency in a better position to manage the implementation of the program.

For example, the agency might consider the likelihood of the following risks in relation to the specific activity being funded:

- personal injury
- property damage
- breach of legislation
- breach of intellectual property rights
- breach of contract
- defamation.

Other non-legal risks, such as financial and reputational risks, should also be assessed. The CGGs also list a range of risks that should be considered.

Selecting grant recipients

The method of selecting grant recipients may differ depending on the nature of the granting activity. For example, some granting activities 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.

The selection process

An agency's principal consideration when selecting grant recipients should be to use Commonwealth funds in a way that is efficient, effective, economical and ethical. 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.

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, 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. There may also be some circumstances where an open process is not appropriate due to a program's objectives.

Where a competitive selection process is run, agencies should ensure that they follow appropriate probity principles (eg 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 assist the agency to maximise the number of suitable grant applications it receives.

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. That said, in most cases 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. A copy of the grant agreement for the program should also be provided.

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 otherwise suitable applicants from the process.

Recipients' capacity to enter into grant agreements

It is usually preferable to enter into a grant agreement with individuals, incorporated entities (eg companies, incorporated associations or Indigenous corporations, bodies corporate established under legislation) or governments. Particular risks are involved where an agency enters into a grant agreement with an unincorporated body or a group of organisations (eg consortia) that does not have the capacity to enter into contracts as a single entity. As a result, any grant agreement entered into with an unincorporated association or joint venture may be unenforceable, or only enforceable against the individual(s) who signed or authorised the signing of the agreement. One of the implications of this is that the agency's ability to enforce the performance of, or recover funds under, the agreement is significantly limited, although the extent to which this is a significant consideration will be a matter for assessment on a case-by-case basis.

If an agency receives a grant application from an unincorporated association, it could consider making the incorporation of the association (eg under the relevant State or Territory associations incorporation Act or, if applicable, the Commonwealth's Indigenous corporations legislation) a precondition to entering into a grant agreement (subject to the association obtaining its own legal advice about the incorporation process and implications).

Where the applicant is an unincorporated group of entities, agencies may need to consider strategies such as entering into the grant agreement with the lead member of the group and recognising the other members of the group in that grant agreement as the lead member's subcontractors. 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.

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 that 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? Are these other sources of funding 'locked in'?

— Is the applicant financially viable?

— Does the project rely on a large number of participants cooperating 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?

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

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

Legal issues when managing a grant agreement

The grant agreement

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

The grant 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 grant agreement. The CGGs provide that an enforceable agreement should be established wherever possible.

A grant 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 grant agreement.

The forms of enforceable grant agreement include a deed, a contract (including an exchange of letters) and a conditional gift. Many agencies seek to impose a range of enforceable conditions in connection with grants. Accordingly, grant agreements are often expressed to be contracts or deeds, with the intention that all of the obligations will be enforceable.

Ultimately, the rights and obligations of the Commonwealth and a grant 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 agency 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.

— 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 financiers.

Community grants

The use of standard forms of grant agreement (where consistent policy positions are taken) by agencies for use in providing grants to community organisations can greatly simplify the grant 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 that they are managing.

Industry development granting activities

In contrast to community granting activities, grant agreements for significant one-off industry grant-giving activities are 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 – it may be necessary for there to be a deed that regulates priority and other obligations between the various funding providers.

Increasingly, there are also situations where agencies seek to fund projects that involve consortiums, including State, local government and industry. 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 that is being funded, the extent to which individual consortium members should also be required to comply with terms equivalent to those in the grant

agreement and the extent to which individual consortium members should be required to report on their use of the funding and repay any funding that they misspend or do not spend.

Common clauses in grant agreements

Regardless of the type of grant 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, whether any GST issues arise and how any GST issues should be dealt with. Agencies should refer to public rulings that are relevant to grants – the main ones are GSTR 2012/2 and GSTR 2006/9 – and should also give consideration to whether s 9-17 of the *A New Tax System (Goods and Services Tax) Act 1999* applies if the agreement involves payments being made by one government-related entity to another government-related entity as defined in that Act.
- where the grant may be provided to the recipient by another government agency or a third party for the same or similar purpose, whether there should be an obligation on the recipient to report on the provision of such funding
- if the grant is payable on the achievement of milestones, the consequences of a recipient failing to achieve the milestone should be 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 may be appropriate.
- in some cases, it will be appropriate to include warranties from the recipient about itself and the project in the grant agreement.

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 requirement to provide regular reports on activities and the acquittal of grant funds).

Mechanisms in projects presenting greater risk may include:

- taking a security interest over assets either explicitly or by including restrictions in the grant agreement on the use of certain assets (often contained in 'asset' clauses)
- 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. These measures are discussed in more detail below.

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. The final funding instalment could 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 granting activities, a small portion (eg 5%) might be payable on completion, whereas with larger-scale industry granting activities the amount might be quite large.

Such a payment structure can help to 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 the grant agreement contains provisions to deal with this. For example, it may be appropriate for the grant agreement to provide that the final funding instalment will only be made to the extent that the acquittal report demonstrates that it is required to reimburse permitted project costs previously incurred by the recipient. Also, in circumstances where the risks are greater (eg 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 to 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.

In addition to the principles set out in the CGGs, the *ANAO's Implementing Better Practice Grants Administration: Better Practice Guide* (June 2010) is a reference point for officials in agencies who wish to obtain more general information about the management of grant arrangements.

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

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 security over property owned by the recipient (such as mortgage or charge over property acquired with the funds) as security for the performance of the recipient's obligations.

The advantages of the agency having security, particularly a registered security, are that it can give the agency the ability to exercise power of sale in the event that the recipient defaults and it improves rights to recover the funds advanced to the recipient. In the case of a registered security, it helps to 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. Policies in relation to ownership of shares and governance arrangements for bodies are set out in Financial Management Reference Material Number 2, 'Governance Arrangements for Australian Government Bodies', issued by the Department of Finance and Deregulation. Agencies should

consult the Department before taking security over shares or investment instruments. Also, different rules apply depending on whether security is taken over real property (land) or personal property (that could include shares, intellectual property, contract rights and physical property such as machinery, vehicles and aircraft).

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, the ability or desire of the agency to exercise the rights provided by the security 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.

Agencies that are involved in grant programs may need to establish internal policies in relation to when they will seek to take security to support obligations of grant recipients under grant agreements. When an agency takes security it becomes a secured creditor, which puts it in a stronger position in the event of insolvency. However, to make security interests effective, the agency will need to have procedures in place that ensure that security interests are registered where necessary. In some cases, the agency will need to enter into arrangements with other secured creditors, such as commercial financiers, that establish the respective rights, priorities and obligations of all of the funding parties.

For further information in relation to securities, see AGS Commercial Notes 33, *Securities: Ensuring payment of debts to the Commonwealth*, 9 November 2009; AGS Legal Briefing 96, *Personal Properties Security Act*, 12 January 2012; and AGS Fact Sheet 20, *The Personal Property Securities Act*, September 2012.

See also AGS *Commercial Notes* 35, *Managing government contracts through financial distress*, 31 May 2012.

Performance guarantee

Where a grant is provided to companies or other entities that 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 grant agreement. In the event that the grant recipient fails to meet its obligations, the entity that 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 grant 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 (including from the Department of Finance and Deregulation) should be sought.

Commonwealth control of funds

If an agency retains control of the funds in the hands of the recipient, the funding may remain 'public money' under the FMA Act after it is paid to the recipient. This may arise if, for example, the program requires involvement of officials in spending decisions by the recipient or if the recipient is left with very little discretion in the day-to-day management of the money because the grant agreement prescribes the persons to whom the recipient may pay the funds and the amount of those payments. In those circumstances, consideration should be given to whether it is possible and appropriate to seek authorisation under s 12 of the FMA Act for an outsider (the funding recipient) to deal with that public money. The power to grant a s 12 authorisation has been delegated to Chief Executives of all FMA Act agencies. The delegation is subject to directions, including as to the matters about which the delegate must be satisfied before entering into an arrangement concerning outsiders. Finance Circular 2011/01: *Commitments to spend public money* (FMA Regulation 7 to 12) provides further guidance on section 12 of the FMA Act.

Documentation

Reporting

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

— regular 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 is 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 ...

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 or the location of the funded project to determine how the grant has been applied.

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 grant 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 dates for payment of funds if the recipient has unspent funds or has not yet 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, grant agreements will require that any variation must be put in writing and signed by the parties' authorised representatives. However, notwithstanding this clause, a grant agreement can inadvertently be varied by other means. Agency officials should be careful not to make statements (orally, in correspondence or 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.

Agency officials must also ensure that any variation to the grant agreement meets the requirements of the FMA Regulations. In particular, the variation must be within the scope of the original FMA reg 9 approval. If not, then a new approval under FMA reg 9 will be required before the variation can be entered into.

Legal issues when ending a grant agreement

In the ordinary course of events, a grant agreement expires on the completion date set out in the agreement or when all of the recipient's obligations under the agreement have been completed. However, in some circumstances, it may become necessary (or desirable) for the agreement to be terminated early. An agency contemplating terminating a grant 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. Advice may be needed on issues such as obligations to use 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*).

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

Is it necessary to terminate the agreement?

An agency might consider terminating a grant 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.

In some cases it may be necessary to terminate the agreement but in other cases it may be appropriate to allow the agreement to simply run its course. For example, if a grant agreement provides for payments to be made on the achievement of particular milestones, a failure to meet the milestones would generally allow the Commonwealth not to make any further payments under the agreement. It would not be necessary to terminate the agreement to achieve this effect (although termination would ensure that the later completion of that milestone cannot reactivate the agreement).

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 rights to be explicitly set out in the agreement. A grant agreement may be terminated in the following ways, depending on the circumstances and the terms of the agreement:

- termination without default (sometimes known as 'termination for convenience'
- termination for default
- termination by mutual agreement.

Termination without default ('for convenience')

The recent case of *NSW Rifle Association Inc v The Commonwealth of Australia* [2012] NSWSC 818 highlights the importance of including in a Commonwealth grant agreement an express right for the Commonwealth to terminate the agreement at any time (ie for convenience) by written notice if the agency requires the flexibility to do so.

Termination for default

It is common for a grant agreement to provide a right to terminate for specific events of default (eg the recipient's company is wound-up or it is subsequently found that the original grant application contained false information). Other acts or omissions by the recipient may also constitute default through the recipient's failure to perform obligations under the agreement (eg 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 grant 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. It will often be in the agency's interest to exhaust all other reasonable 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 grant agreement relating to the exercise of the right to terminate for default.

In some cases it may also be necessary to consider any 'good faith' obligations that the agency may have – see AGS Commercial Note 34, *The Commonwealth as a model contractor? Good faith in government contracting*, 21 July 2010.

Wrongful termination

Agencies should take care when exercising either of the termination rights described above. If an agency wrongfully terminates an agreement, this could amount to a repudiation of the agreement and the agency could be liable to pay a monetary amount as damages to the recipient.

Termination by agreement

Of course, the agency and the recipient may simply agree to terminate the agreement. That would typically require 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 and the effect of ending the project. This is another reason why it is important to seek legal advice before exercising termination rights.

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. This is likely to depend on the terms of the grant agreement.

If an agreement is terminated for default, agencies need to consider whether to claim damages from the recipient or to pursue recovery of costs, funding (including unspent funds) or the funded assets from the recipient.

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

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

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 7 years: s 286). It is also common for agencies to consider including in grant agreements a requirement for the grant recipient to provide a final report to the agency within a certain period (eg 40 business days) of the completion of the project.

Unspent funds

Rights under the grant agreement

Where any termination right is exercised, the grant agreement will normally provide the agency with the power to recover funds that have not been:

— legally committed for expenditure and therefore are not payable as a current liability, or

— spent in accordance with the agreement.

Where this is the case, the grant agreement may provide that these funds are recoverable as a debt due to the Commonwealth without the requirement for further proof. However, agencies should note that, if the required final acquittal 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 – the power to waive a debt under s 34 of the FMA Act can only be exercised by the Finance Minister or their delegate under s 34 of the FMA Act.

Can an agency spend recovered funds?

In the event that unspent money is recovered from the recipient (including following termination of a grant agreement) there may be scope to allocate this money to another recipient or other agency activities.

Increases to appropriations following 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:

- Confirm that there is a statutory basis for making the grant payment at the start and throughout the life of the granting activity.
- Agencies must comply with the CGGs in implementing granting activities.
- 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 assist.
- Agencies need to give careful consideration to what rights and responsibilities they wish to impose in a program's grant agreement, having regard to nature of the potential recipients and the program. Some programs and projects will require more tailored grant agreements than others. This will dictate the appropriate type of grant agreement.
- 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 grant agreements, particularly through verbal discussions and email exchanges.
- A decision to terminate a grant agreement needs careful consideration and, typically, should only occur based on legal advice.
- A number of Commonwealth laws are relevant for grant recipients. AGS has prepared a fact sheet for grant recipients which is available on the AGS website at http://www.ags.gov.au/publications/index.html.

This briefing was prepared by Leah West, Kathryn Grimes and David Lewis with assistance from Vesna Vuksan, Irene Ghobreal and Samantha Arnold.

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Notes

1 See also Federal Finance Circular 2011/03: *Processes for drafting, negotiating, finalising and varying agreements under the Federal Financial Relations Framework, and related estimates and payments processes* at http://www.federalfinancialrelations.gov.au/content/circulars/circular_2011_03.pdf

2 http://finance.gov.au/financial-framework/fma-legislation/fma-delegations.html

3 An exception to this statement would be where a CAC Act body is the recipient under a grant agreement with an FMA Act agency that is the subject of a s 12 FMA Act authorisation.

4 ANAO Audit Report No. 36 2011–12: *Development and Approval of Grant Program Guidelines* notes that in September 2010 it was decided that draft program guidelines are to be submitted for ERC approval on a case-by-case basis, according to a risk assessment undertaken by the administering agency, ANAO Audit Report No. 36 2011–12: *Development and Approval of Grant Program Guidelines*.

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AGS has a national team of lawyers specialising in grants and funding projects. For further information on the article in this issue, or on other funding matters, please contact the authors or any of the lawyers listed below.

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