IAS 20 Accounting for Government Grants and Disclosure of Government Assistance - A Closer Look

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IAS 20, Accounting for Government Grants and Disclosure of Government Assistance – A Closer Look

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International Accounting Standard (IAS) 20, *Accounting for Government Grants and Disclosure of Government Assistance*, prescribes the accounting for government grants. In September 1981, the International Accounting Standards Committee (IASC) issued the Exposure Draft E21, *Accounting for Government Grants and Disclosure of Government Assistance*. In April 1983, the IASC issued IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, effective from January 1, 1984. In 1994, the IAS 20 (1983) was reformatted. On May 22, 2008, IAS 20 amended for 'Annual Improvements to International Financial Reporting Standards (IFRSs) 2008', effective from January 1, 2009.

Objective

The objective of IAS 20 is to prescribe the accounting treatment for, and disclosure of, government grants and other forms of government assistance.

Government assistance takes many forms varying both in the nature of the assistance given and in the conditions which are usually attached to it. The purpose of the assistance may be to encourage an entity to embark on a course of action which it would not normally have taken if the assistance was not provided.

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The receipt of government assistance by an entity may be significant for the preparation of the financial statements for two reasons. Firstly, if resources have been transferred, an appropriate method of accounting for the transfer must be found. Secondly, it is desirable to give an indication of the extent to which the entity has benefited from such assistance during the reporting period. This facilitates comparison of an entity's financial statements with those of prior periods and with those of other entities.

Scope and Application

IAS 20 applies to all government grants and other forms of government assistance, but does not apply to:

• Government assistance that is provided for an entity in the form of benefits that are available in determining taxable income or are determined or limited on the basis of income tax liability (such as income tax holidays, investment tax credits, accelerated depreciation allowances and reduced income tax rates)

• Government participation in the ownership of the entity, i.e. grants-in-aid or (less likely) grants given to support the general revenue and capital expenditure of an entity

• Government grants covered by IAS 41, *Agriculture*.

• Special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices or in supplementary information of a similar nature.

The benefit of a government loan at a below-market rate of interest is treated as a government grant. Government grants are sometimes called by other names such as subsidies, subventions, or premiums.

Key Definitions

Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm’s length transaction.

Forgivable loans are loans which the lender undertakes to waive repayment of under certain prescribed conditions.

Government refers to government, government agencies and similar bodies whether local, national or international.

Government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria. Government assistance for the purpose of this Standard does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.

Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

Grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.
Grants related to income are government grants other than those related to assets.

Prescribed Accounting Treatment

Why Bother Reporting Receipts of Government Grants?
Firstly, if resources have been transferred, an appropriate method of accounting for the transfer must be found.
Secondly, it is desirable to give an indication of the extent to which the entity has benefited from such assistance during the reporting period.

Recognition of Government Grants

Government grants, including non-monetary grants at fair value, shall not be recognised until there is a reasonable assurance that:
• the entity will comply with the conditions attaching to the grants
• the grants will be received.

Government grants include grants of cash and non-monetary assets, and reductions of liabilities. They are recognised at their fair value. After recognition, any related contingent liability or contingent asset is treated in accordance with IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

The manner in which a grant is received does not affect the accounting method to be adopted in regard to the grant.

Accounting Treatment of Government Grants

Two broad approaches may be found to the accounting treatment of government grants: the capital approach, under which a grant is credited directly to shareholders' interests, and the income approach, under which a grant is taken to income over one or more periods.

Capital Approach: Those in support of the capital approach argue as follows:
(a) government grants are a financing device and should be dealt with as such in the balance sheet rather than be passed through the income statement to offset the items of expense which they finance. Since no repayment is expected, they should be credited directly to shareholders' interests; and
(b) it is inappropriate to recognise government grants in the income statement, since they are not earned but represent an incentive provided by government without related costs.

Income Approach: Arguments in support of the income approach are as follows:
(a) since government grants are receipts from a source other than shareholders, they should not be credited directly to shareholders' interests but should be recognised as income in appropriate periods;
(b) government grants are rarely gratuitous. The entity earns them through compliance with their conditions and meeting the envisaged obligations. They should therefore be recognised as income and matched with the associated costs which the grant is intended to compensate; and
(c) as income and other taxes are charges against income, it is logical to deal also with government grants, which are an extension of fiscal policies, in the income statement.

It is fundamental to the income approach that government grants be recognised as income on a systematic and rational basis over the periods necessary to match them with the related costs. Income recognition of government grants on a receipts basis is not in accordance with the accrual accounting assumption (see IAS 1, *Presentation of Financial Statements*) and would only be acceptable if no basis existed for allocating a grant to periods other than the one in which it was received.

In most cases the periods over which an entity recognises the costs or expenses related to a government grant are readily ascertainable and thus grants in recognition of specific expenses are recognised as income in the same period as the relevant expense. Similarly, grants related to depreciable assets are usually recognised as income over the periods and in the proportions in which depreciation on those assets is charged.

Grants related to non-depreciable assets may also require the fulfilment of certain obligations and would then be recognised as income over the periods which bear the cost of meeting the obligations. As an example, a grant of land may be conditional upon the erection of a building on the site and it may be appropriate to recognise it as income over the life of the building.

Grants are sometimes received as part of a package of financial or fiscal aids to which a number of conditions are attached. In such cases, care is needed in identifying the conditions giving rise to costs and expenses which determine the periods over which the grant will be earned. It may be appropriate to allocate part of a grant on one basis and part on another.

A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognised as income of the period in which it becomes receivable.

In some circumstances, a government grant may be awarded for the purpose of giving immediate financial support to an entity rather than as an incentive to undertake specific expenditures. Such grants may be confined to an individual entity and may not be available to a whole class of beneficiaries. These circumstances may warrant recognising a grant as income in the period in which the entity qualifies to receive it, with disclosure to ensure that its effect is clearly understood.

A government grant may become receivable by an entity as compensation for expenses or losses incurred in a previous period. Such a grant is recognised as income of the period in which it becomes receivable, with disclosure to ensure that its effect is clearly understood.

Presentation of grants

Grants related to assets

Government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet either by setting up the grant as deferred income, or by deducting the grant in arriving at the carrying amount of the asset.

Two methods of presentation in financial statements of grants (or the appropriate portions of grants) related to assets are regarded as acceptable alternatives. One method sets up the grant as deferred income which is recognised as income on a systematic and rational basis over the useful life of the asset. The other method deducts the grant in arriving at the carrying amount of the asset. The grant is recognised as income over the life of a depreciable asset by way of a reduced depreciation charge.

The purchase of assets and the receipt of related grants can cause major movements in the cash flow of an entity. For this reason and in order to show the gross investment in assets, such movements are often disclosed as separate items in the cash-flow statement regardless of whether or not the grant is deducted from the related asset for the purpose of balance sheet presentation.

Grants related to income

Grants related to income are presented as (a) a deferred credit in the income statement, either separately or under a general heading such as ‘other income’ or (b) deducted in reporting the related expense.

Supporters of the first method claim that it is inappropriate to net income and expense items and that separation of the grant from the expense facilitates comparison with other expenses not affected by a grant. For the second method it is argued that the expenses might well not have been incurred by the entity if the grant had not been available and presentation of the expense without offsetting the grant may therefore be misleading.

Both methods are regarded as acceptable for the presentation of grants related to income. Disclosure of the grant may be necessary for a proper understanding of the financial statements. Disclosure of the effect of the grants on any item of income or expense which is required to be separately disclosed is usually appropriate.

Repayment of Government Grants

A government grant that becomes repayable shall be accounted for as a revision to an accounting estimate (see IAS 8*, Accounting Policies, Changes in Accounting Estimates and Errors*). For example:

• for grants related to income, the amount of the repayment first reduces any unamortised deferred credit set up in respect of the grant, or where no deferred credit remains or exists, the repayment shall be recognised as an expense
• for grants related to assets, the repayment shall be recorded by increasing the carrying amount of the asset or reducing the deferred income balance by the amount repayable.

Forgivable loans
Forgivable loans from the government are treated as government grants when there is reasonable assurance that the entity will meet the terms for the forgiveness of the loan.

Non-monetary government grants

A government grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the entity. In these circumstances it is usual to assess the fair value of the non-monetary asset and to account for both grant and asset at that fair value. An alternative course that is sometimes followed is to record both asset and grant at a nominal amount.

Government Assistance

Government grants do not include certain forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

Examples of assistance that cannot reasonably have a value placed upon them are free technical or marketing advice and the provision of guarantees. An example of assistance that cannot be distinguished from the normal trading transactions of the entity is a government procurement policy that is responsible for a portion of the entity's sales.

The existence of the benefit might be unquestioned but any attempt to segregate the trading activities from government assistance could well be arbitrary.

The significance of the benefit in the above examples may be such that disclosure of the nature, extent and duration of the assistance is necessary in order that the financial statements may not be misleading.

Loans at nil or low interest rates are a form of government assistance, but the benefit is not quantified by the imputation of interest.

In this standard, government assistance does not include the provision of infrastructure by improvement to the general transport and communication network and the supply of improved facilities such as irrigation or water reticulation which is available on an ongoing indeterminate basis for the benefit of an entire local community.

Prescribed Disclosures

Required disclosures include:
• the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements
• the nature and extent of government grants recognised in the financial statements and an indication of other forms of government assistance from which the entity has directly benefited
• unfulfilled conditions and other contingencies attaching to government assistance that has been recognised.

Transitional Provisions

An entity adopting the standard for the first time shall:
(a) comply with the disclosure requirements, where appropriate; and
(b) either: (i) adjust its financial statements for the change in accounting policy in accordance with IAS 8, or (ii) apply the accounting provisions of the standard only to grants or portions of grants becoming receivable or repayable after the effective date of the standard.

Contact information

SIC Interpretation

The Standards Interpretations Committee (SIC) of the IASC has issued the following Interpretation relating to IAS 20:

- • SIC 10, *Government Assistance - No Specific Relation to Operating Activities* (issued in July 1998, effective from August 1, 1998)

In some countries, government assistance to entities can be aimed at encouragement or long-term support of business activities either in certain regions or industry sectors. Conditions to receive such assistance may not be specifically related to the operating activities of the entity.

Examples of such assistance are transfers of resources by governments to entities which:
(a) operate in a particular industry;
(b) continue operating in recently privatised industries; or
(c) start or continue to run their business in underdeveloped areas.

The issue is whether such government assistance is "a government grant" within the scope of IAS 20 and should therefore be accounted for in accordance with this Standard.

Under SIC 10, government assistance to entities that is aimed at encouragement or long-term support of business activities either in certain regions or industry sectors meets the definition of government grants in IAS 20. Such grants should therefore not be credited directly to shareholders' interests.

This interpretation concerns the treatment of government assistance which is given to encourage or provide long-term support to business activities either in certain regions or industry sectors. Although such assistance may not be specifically related to the operating activities of the entity, the consensus was that it meets the definition of government grants even though there may be no conditions other than a requirement to operate in certain regions or industry sectors SIC 10 notes that such grants should not be credited to equity.

Project to Reconsider IAS 20

This project had started as part of the short-term convergence project of the International Accounting Standards Board (IASB) designed to eliminate a variety of differences between IFRS and US generally accepted accounting principles (GAAP). However, the project has evolved into a stand-alone (non-convergence) IASB project to reconsider IAS 20. In late 2005 the IASB stated that the objective of the project is to amend IAS 20 by applying the accounting model for government grants contained in IAS 41 to all government grants. The IAS 41 model establishes the following principles for recognising grants related to assets measured at fair value through profit and loss:

- Recognise the grant when it becomes receivable.
- Recognise income when conditions attached to the grant have been met.

In July 2002 IASB Meeting, the IASB believes that IAS 20 is out of date and inconsistent with the *Framework*.

In the February 2004 IASB Meeting, the staff presented two options, namely:

- Amend IAS 20 to reflect the requirements for government grants contained in IAS 41
- Withdraw IAS 20 in its entirety

The staff recommended the second option and that the Basis for Conclusions should state:

- The standard has been withdrawn because it is an impediment to accounting for a government grant in a manner that is consistent with the *Framework*;
- The withdrawal is a temporary measure, because the IASB is addressing the accounting of government grants as part of its revenue recognition project;
- Entities should follow the requirements in paragraphs 10-12 of IAS 8 for developing an accounting policy in the absence of specific requirements.

The IASB decided that IAS 20 should be retained. The guidance in the standard on accounting for government grants should be removed and replaced with the guidance from IAS 41. The IASB decided the only amendment to the guidance in IAS 41 should be to withdraw the references to assets measured at fair value. The IASB agreed in principle that no further amendments should be made until such time as the revenue recognition project is completed.

At the July 2004 IASB Meeting, the previous decisions to replace the provisions of IAS 20 with a standard based on guidance for recognising grants in IAS 41 were noted.

The staff noted that there was a potential inconsistency between the government grant liability measurement and revenue recognition requirements of IAS 41 and the proposed changes to IAS 37 and the Revenue Recognition project. The inconsistency relates to the delay in revenue recognition under IAS 41 requirements until a specified condition is satisfied at which time the full grant is recognised in revenue.

The staff noted that IAS 41 refers to conditional and unconditional grants but does not provide sufficient guidance on what is meant by conditional in this context.

Recognition of government grant as an asset or reduction of liability: The staff recommended that an entity should recognise a government grant as an asset at the earlier of the entity:

- having an unconditional right to receive the government grant without conditions attached to its retention; and

- receiving the government grant.

A number of Board members noted that this was not their preferred solution but agreed that further development is outside the scope of the short-term convergence project. After discussion the IASB agreed not to provide guidance on whether an asset and liability would be recognised when a repayment clause is attached to a condition or whether no asset should be recognised at all until the grant is fully non-repayable.

Testing an asset for impairment: The staff recommended that an asset acquired in connection with a government grant should be tested for impairment on initial recognition. The IASB agreed subject to adding clarification that any liability recognised in relation to the grant be considered as part of the cash generating unit.

Loans at nil or low interest rates: The staff recommended removing the reference to these loans from the proposed government grants standard so that they would be accounted for under IAS 39, *Financial Instruments: Recognition and Measurement*. The IASB agreed.

The IASB agreed to require retrospective application except for the impracticability exemption and to request commentators to provide details of circumstances where this would not be possible.

In June 2005, the IASB withdrew International Financial Reporting Interpretations Committee (IFRIC) Interpretation 3, *Emission Rights*. At that time, it indicated that it intended to address emission rights in a separate exposure draft early in 2006. Subsequently, in January 2006, the IASB has determined that since emission rights are a form of government grant, they should be addressed in the project to reconsider IAS 20.

At the February 2006 Meeting, the IASB discussed the current status of the project to revise IAS 20. In addition, they discussed a request from the national standard-setter in New Zealand that IAS 20 be withdrawn.

Although some Board members thought that withdrawing IAS 20 would be a step in the right direction, the majority thought that the accounting vacuum that it would leave behind was not desirable. Nor was the accounting for grants in IAS 41 thought to be necessarily superior.

The IASB noted that certain issues related to recognising and measuring obligations under grants with conditions attached are similar to issues related to recognising and measuring provisions under IAS 37. Because the IASB is currently reconsidering IAS 37 as part of the Business Combinations Phase II project, it decided to defer work on the IAS 20 project pending final decisions on revision of IAS 37, which are expected in mid-2007 (8 in favour; 6 opposed). This decision effectively means that work on accounting for emission trading schemes will also be deferred.

In December 2007, the IASB agreed to add to its agenda a project limited to addressing the following key issues related to Emission Rights Trading Schemes:

1. Are the tradeable permits in emission trading schemes (allowances and credits) assets? If so:

2. How should an entity account for any allowances that it receives from government for less than fair value?

3. How should allowances and credits be accounted for?

4. How should changes in assets and liabilities (arising from emission trading schemes) be reported in profit or loss?

The outcome of that project is not expected to result in a new IFRS. Rather, the IASB plans to address the issues by:

- a revision of either IAS 38, *Intangible Assets* or IAS 39 to accommodate the accounting for tradeable permits, and

- a revision of IAS 20 so that the accounting for allowances (and similar assets) issued by governments free of charge is addressed.

2008 Amendment – Improvements to IAS 20

The IASB published on May 22, 2008, "Improvements to IFRSs 2008". IAS 20 was amended based on this project in the following areas:

• eliminating inconsistencies with the *Framework*, in particular the recognition of a deferred credit when the entity has no liability; and
• eliminating options that can reduce the comparability of financial statements and understate the assets controlled by an entity.

Next steps

The IASB has many reservations about the requirements of IAS 20, in particular:
• The recognition requirements of IAS 20 often result in accounting that is inconsistent with the *Framework*. For example, the requirement in paragraph 12 to recognise grants 'as income over the periods necessary to match them with the related costs which they are intended to compensate' can result in an entity recognising an amount in the statement of financial position as a deferred credit when the entity has no liability.
• As well as being inconsistent with the *Framework*, the recognition requirements of IAS 20 are also inconsistent with more recent pronouncements of standard-setting bodies relating to either non-reciprocal transfers in general or, more specifically, government grants. For example, the US Financial Accounting Standards Board (FASB) Statement No. 116, *Accounting for Contributions Received and Contributions Made* (SFAS 116), whilst exempting government grants to business entities from its scope, provides an accounting model that can be applied to government grants and that is consistent with the *Framework*. In Australia, UIG Abstract 11 *Accounting for contributions of, or contributions for the acquisition of, non-current assets*, whilst specifying a different treatment for contributions subject to conditions than SFAS 116, is also consistent with the *Framework*. International Public Sector Accounting Standard 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* is also based on principles that are consistent with the *Framework*.
• IAS 20 contains numerous options. For example, an entity that receives a grant to finance the acquisition of an item of property, plant or equipment is entitled to deduct the grant from the carrying amount of that item, and an entity that receives a non-monetary grant is permitted to measure the asset and the grant at a nominal amount rather than fair value. In addition to reducing the comparability of financial statements, these particular options in IAS 20 result in understatement of the assets controlled by the entity and do not provide the most relevant information to users of financial statements.

Distinguishing between unconditional and conditional grants

IAS 41 distinguishes between unconditional and conditional grants. An unconditional grant is recognised as income when the grant becomes receivable; a conditional grant when the condition is satisfied. IAS 41, however, contains little guidance about what is meant by unconditional or conditional in this context. Therefore the IASB decided to define a condition for the purposes of revised IAS 20 as a stipulation that entitles government to the return of the granted resources if a specified event either occurs or does not occur. The IASB also noted that any such stipulation should have commercial substance to be regarded as a condition.

Recognition of grant as an asset or as a reduction in a liability

IAS 41 specifies when a government grant is recognised as income. It does not specify when the transfer of resources from government is recognised. Therefore, the IASB decided to specify that an entity should recognise a government grant as an asset at the earlier of (i) having an unconditional right to receive the government grant (regardless of whether there are conditions attached to retaining the grant) and (ii) receiving the government grant. The IASB decided that if the grant involves government waiving repayment of all or part of a liability, the reduction in liability should be recognised when the liability is discharged or cancelled.

Definition of a government grant

A government grant is defined in IAS 20 as a transfer of resources "in return for past or future compliance with certain conditions relating to the operating activities of the entity". The IASB observed that in an accounting model that distinguishes between conditional and unconditional grants, the use of the word 'conditions' in this definition could be confusing. Therefore, the IASB decided to delete the phrase 'in return for past or future compliance with certain conditions relating to the operating activities of the entity' from the definition of a government grant. The IASB also decided to provide additional guidance in the amended Standard to clarify which transactions with government meet the definition of a grant.

Conflict with IAS 39

IAS 20 explains that loans at nil or low interest rates are forms of government assistance, but the benefit of the reduced loan is not treated as a government grant.

Similarly, a government may guarantee an entity's borrowing, but IAS 20 does not treat the benefit of the guarantee as a government grant. The IASB noted that these requirements of IAS 20 conflict with IAS 39 because IAS 39 requires financial liabilities to be measured initially at fair value. Therefore, the IASB decided to delete the references to loans at nil or low interest rates and guarantees from paragraphs 35 and 37 of IAS 20.

Impairment

The IASB decided that entities that receive a government grant in connection with the acquisition of an asset should be required to test that asset for impairment in accordance with IAS 36, *Impairment of Assets* on its initial recognition. The IASB also decided to clarify that any recognised liability arising from conditions attaching to the grant should be included in the same cash-generating unit as the acquired asset.

Transition requirements for the amendments to IAS 20

The IASB decided to propose retrospective application in accordance with IAS 8. However, it decided to ask constituents to provide details of circumstances in which this requirement would cause difficulties.

Comparative Indian Standard

The Accounting Standard issued by the Institute of Chartered Accountants of India (ICAI) comparative to IAS 20 is AS 12, *Accounting for Government Grants*. AS 12 revised corresponding to IAS 20 has been approved by the Council and the NACAS. There is no difference between the Draft of the standard and IAS 20.

Conclusion

The scope of the 'Emission Rights Trading Schemes Project' addresses only emission trading rights, including any government grants associated with such emission trading rights, but does not address government grants more generally. The IASB does not now have a plan for comprehensive reconsideration of IAS 20.

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