**IAS 20-Accounting for Government Grants**

 **and Disclosure of Government Assistance**

**1-Overview**

In April 2001 the International Accounting Standards Board adopted IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, which had originally been issued by the International Accounting Standards Committee in April 1983. Other Standards have made minor consequential amendements to IAS 20. They include IFRS 13 Fair Value Measurement (issued May 2011), Presentation of Items of Other Comprehensive Income (Amendments to IAS 1) (issued June 2011), IFRS 9 Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39) (issued November 2013) and IFRS 9 Financial Instruments (issued July 2014).

**2-Objective of IAS 20 :**

The objective of IAS 20 is to prescribe the accounting treatment for government grants and how to recognize them. The standard also addresses the requirements for disclosure of government aid whose assets are not transferred to the entity. Government grants are government assistance that requires the transfer of resources in exchange for commitment, whether past or future, to certain conditions related to the facility’s operational activities, such as cleaning up environmental pollution caused by the facility.

**3-Scope**

 This Standard shall be applied in accounting for, and in the disclosure of, government grants and in the Disclosure of other forms of government assistance.

Some exeptions have been made by the standard :

 (a) the 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.

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

 (c) government participation in the ownership of the entity.

 (d) government grants covered by IAS 41 Agriculture.

4- **Definitions**

 The following terms are used in this Standard with the meanings specified:

|  |
| --- |
| **Fair value.** 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**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. 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. .**Forgivable loans**are loans which the lender undertakes to waive repaymentof under certain prescribed conditions.**Government assistance** takes many forms varying both in the nature of theassistance 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 acourse of action which it would not normally have taken if the assistance wasnot provided. |

**5-Recognition of Government Grant**

**5.1- Criteria for Recognition :**

Government grants, including non-monetary grants at fair value, shall not

be recognised until there is reasonable assurance that:

**(a) the entity will comply with the conditions attaching to them; and**

**(b) the grants will be received**

A government grant is not recognised until there is reasonable assurance that

the entity will comply with the conditions attaching to it, and that the grant

will be received. Receipt of a grant does not of itself provide conclusive

evidence that the conditions attaching to the grant have been or will be

fulfilled..

**5.2-** The Standard discusses two broad approaches with respect to the accounting treatment of government grants.

**The “capital approach**” which requires a government grant to be directly credited to the shareholders’ equity.

 **The “income approach**. Government grants should be recognized as income, on a systematic and rational basis, over the periods necessary to match them with the related costs. It is fairly evident that IAS 20 is not in favor of the capital approach,. Supporting the income approach, the Standard sets out this rule for recognition of government grants:

In setting out this rule, the Standard expands it further and lays down additional principles for recognition of grants under different conditions. These rules are explained below :

**Principle 1: “Grants in recognition of specific costs are recognized as income over the same period as the relevant expense**

**Ex1-** Brilliant Inc. received a grant of $60 million to compensate it for costs it incurred in planting trees over a period of five years. Brilliant Inc. will incur such costs in this manner:

|  |  |
| --- | --- |
| **Year**  | **Costs** |
| 12345 | £2 million£4 million£6 million£8 million£10 million |

Total costs thus incurred will aggregate to £30 million, whereas the grant received is $60 million.

**Required**

Based on the provisions of IAS 20, how would Brilliant Inc. treat the “grant” in its books ?

**Principle 2**: “Grants related to depreciable assets are usually recognized as income over the periods and in the proportions in which depreciation on those assets is charged.”

Ex2- The Arab Food Industries Company received a grant worth160 million dinars to install water purification devices to be used in food production, the company estimated the cost of these devices at 200 million dinars.These devices will be depreciated on a straight-line basis over their life of 4 years.

**Required:** Advise this company on the treatment of this grant in accordance with IAS 20

**Principle 3: “**Grants related to non-depreciable assets may also require the fulfillment of certain obligations and would then be recognized as income over periods which bear the cost of meeting the obligations**.**

A government grant may not always be given in cash or cash equivalents. Sometimes a government grant may take the form of a transfer of a nonmonetary asset, such as grant of a plot of land or a building in a remote backward area. In these circumstances, the Standard prescribes these optional

accounting treatments:

• To account for both the grant and the asset at the **fair value** of the nonmonetary asset, or

• To record both the asset and the grant at a “**nominal amount.**

**Ex3-**Company X was granted 5,000 acres of land in a village, located near the slums outside the city limits, by a local government authority. The condition attached to this grant was that Citimart Inc. should clean up this land and lay roads by employing laborers from the village in which the land is located. The government has fixed the minimum wage payable to the workers. The entire operation will take three years and is estimated to cost 100 million dinars. This amount will be spent in this way: 20 million dinars each in the first

and second years and 60 million Dinars in the third year. The fair value of this land is currently 120 million dinars.

**Required-**Based on the principles laid down for accounting and recognition of grants, how should this grant be treated in the books of Company X.?

**Principle 4: “**Grants are sometimes received as part of a package of financial or fiscal aids to which a number of conditions are attached.”

**Ex4**-Company Y. received a consolidated grant of 140 million dinars. Three-fourths of the grant is to be utilized to purchase a college building for students its usefull life was 10 years . The balance of the grant is for subsidizing the tuition costs of those students for four years from the date of the grant.

The grant would first be apportioned as

Grant related to assets (3/4) =105 m.Dinars

Grant related to income (1/4) =35 m.Dinars

**Required**

Advise Company Y. on the treatment of the grant in accordance with IAS 20.

**Principle 5: “**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 should be recognized as income of the period in which it becomes receivable.

**7- PRESENTATION OF GRANTS RELATED TO ASSETS**

**7.1- Presentation on the Balance Sheet**

Government grants related to assets, including nonmonetary grants at fair value, should be presented in the balance sheet in either of two ways:

(1) By setting up the grant as deferred income

(2) By deducting the grant in arriving at the carrying amount of the asset

**Ex5-**Company X. received a grant related to a factory building that it bought in 2022. The total amount of the grant was £9 million. Taj Corp. acquired the building from an industrialist identified by the government.

If Company X. did not purchase the factory building, which was located in the slums of the city, it would have been repossessed by a government agency. Company X purchased the factory building for £27 million. The useful life of the building is not considered to be more than three years, mainly due to the fact

that it was not properly maintained by the previous owner.

***Solution***

**Under Option 1:** Set up the grant as deferred income.

• The grant of £9 million would be set up initially as deferred income in 2005.

• At the end of 2022, £3 million would be recognized as income, and the balance of £6 million would be carried forward in the balance sheet.

• At the end of 2023, $3 million would be taken to income, and the balance of £3 million would be carried forward in the balance sheet.

• At the end of 2024, £3 million would be taken to income.

**Under Option 2:** The grant will be deducted from carrying value.

The grant of £9 million is deducted from the gross book value of the asset to arrive at the carrying value of £18 million. As the useful life is three years, annual depreciation of £6 million per year is charged to

the income statement for the years 2022, 2023, and 2024.

**Under the second option, the grant is indirectly recognized in income through the reduced depreciation charge of £3 million per year. Under the first option, it is taken to income directly**.

**7.2-Presentation in the Cash Flow Statement**

When grants related to assets are received in cash, there is an inflow of cash to be shown under the investing activities section of the cash flow statement. Furthermore, there would also be an outflow resulting from the purchase of the asset. IAS 20 specifically requires that both these movements should be shown separately and not be netted.

**7.3**-**Presentation of Grants Related to Income**

The Standard allows a free choice between two presentations

**Option 1**: Grant presented as a credit in the income statement, either separately or under a general heading other income

**Option 2:** Grant deducted in reporting the related expense.

**8-REPAYMENT OF GOVERNMENT GRANTS**

When a government grant becomes repayable, for example, due to nonfulfillment of a condition attaching to it, it should be treated as a change in estimate under IAS 8 and accounted for prospectively.

**Accounting treatment (capital grant repayment):**

8.1-**Repayment of a grant related to income should** :

• First be applied against any unamortized deferred income (credit) set up in respect of the grant.

• To the extent the repayment exceeds any such deferred income (credit), or in case no deferred credit exists, the repayment should be recognized immediately as an expense.

**Dr Income statement(**Expense) **Cr Cash**

EX6- Company X received a grant worth 700,000 dinars on january 1,2022 from a government donor on the condition that the environment surrounding the company’s factories be cleaned within the next three years. The company incurred the following costs:

|  |  |
| --- | --- |
| **Year** | **Costs incurred** |
| **2021****2022****2023****Total** | **240000****60000****300000****600000** |

Suppose that the government which provided the grant demanded the company at the beginning of 2024 to refund for part of the grant wkth the amount of 450,000 dinars as a result of the company’s violation of some of the terms of the grant. The Company paid the amount in cash on April 4,2024.

**Required**: Explain how to treat the amount repaid from the grant, assuming that the company used the method of presenting the grant as deferred income.

**Solution**

The balance of deferred grant income on **Jan.1,2024** equals 350000 dinars.

Since the value of the refunded amount of 450,000 dinars exceeds the balance of deferred grant income, the remaining amount of 100,000 dinars is recognized as an expense. Accordingly, the recording of the refunded amount of the grant appears as follows:

|  |  |  |
| --- | --- | --- |
| **Dr Deferred grant income** **Refunded grant expenses**  **Cr Cash**  | **350000****100000** | **450000** |

8.2-**Repayment of a grant related to an asset**

• Should be recorded by increasing the carrying amount of the asset or reducing the deferred income balance by the amount repayable

• The cumulative additional depreciation that would have been recognized to date as an expense in the absence of the grant should be recognized immediately as an expense.

 **Dr Any deferred Income Balance or Dr Cost of asset
 Dr Income statement with any balance**

**And CR cash with the amount repaid**

**The extra depreciation to date that would have been recognised had the grant not been netted off against cost should be recognised immediately as an expense**.

**EX7**- Company Y. received a government grant amounting to 400,000 dinars on Jan.1 ,2022. As a government Grant to purchase devices to reduce pollution resulting from the factory’s production operations. The company purchased the devices for 610,000 Dinars, with a usefull life of three years and it will be depreciated using straight line basis with no scrap value.

The government who provided the above grant requested a company to pay 100,000 dinars as a result of the company’s breach of some of the terms of the grant. The company paid the amount in cash.

**Required**

Explain how the refund amount of the grant will be treated assuming that the company uses the grant presentation method as a reduction of the Asset.

**EX8**- On 1 January 20X6, Gardenbugs Co received a $30,000 government grant relating to equipment which cost $90,000 and had a useful life of six years. The grant was netted off against the cost of the equipment.

On 1 January 20X7, when the equipment had a carrying amount of $50,000, its use was changed so that it was no longer being used in accordance with the grant. This meant that the grant needed to be repaid in full but by 31 December 20X7, this had not yet been done.

**Required**: Explain how the refund amount of the grant will be treated assuming that the company uses the grant presentation method as a reduction of the Asset.

used.

**9-GOVERNMENT ASSISTANCE**

Government assistance includes government grants. IAS 20 deals with both accounting and disclosure of government grants but only with disclosure requirements of government assistance. Thus government assistance comprises government grants and other forms of government assistance (i.e., those not involving transfer of resources).

**10-DISCLOSURES**

IAS 20 prescribes these three disclosures:

(1) The accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements

(2) The nature and extent of government grants recognized in the financial statements and an indication of other forms of government assistance from which the entity has directly benefited

(3) Unfulfilled conditions and other contingencies attaching to government assistance that has been recognized

**5.2**-The manner in which a grant is received does not affect the accounting

method to be adopted in regard to the grant. Thus a grant is accounted for in

the same manner whether it is received in cash or as a reduction of a liability

to the government.

**5.3**-A forgivable loan from government is treated as a **government grant** when

there is reasonable assurance that the entity will meet the terms for

forgiveness of the loan.

**5.4**-The benefit of a government loan at a below-market rate of interest is treated

as a government grant. The loan shall be recognised and measured in

accordance with IFRS 9 *Financial Instruments*. The benefit of the below-market

rate of interest shall be measured as the difference between the initial

carrying value of the loan determined in accordance with IFRS 9 and the

proceeds received. The benefit is accounted for in accordance with this

Standard. The entity shall consider the conditions and obligations that have

been, or must be, met when identifying the costs for which the benefit of the

loan is intended to compensate

**5.5**-Once a government grant is recognised, any related contingent liability or

contingent asset is treated in accordance with IAS 37 *Provisions, Contingent*

*Liabilities and Contingent Assets*.

**Government grants shall be recognised in profit or loss on a systematic**

**basis over the periods in which the entity recognises as expenses the**

**related costs for which the grants are intended to compensate.**

There are two broad approaches to the accounting for government grants:

**The capital approach**, under which a grant is recognised outside profit or loss, and,

**the income approach**, under which a grant is recognised in profit or loss over

one or more periods.

**6-Grants related to income :**

Cash grants are treated as income during the grant period and corresponding to the expenses associated with the grant, that is, according to the percentage of fulfillment of the grant conditions. The benefit resulting from the establishment obtaining a government loan at an interest rate lower than the market interest rate is treated as a government grant**.**

**Tutorial**

**Facts**

On 1 April 2019, a company which prepares financial statements to 31 March acquires an item of property, plant and equipment and receives a government grant of 40% towards the item's cost. The item costs £250,000 and has a useful life of four years. Its residual value is £60,000.

**Required**

(a)Calculate the amount of the grant that should be recognised as income for each of the four years to 31 March 2023 if the asset is depreciated:on the straight-line basis

 (b) Assuming that the straight-line basis is used, explain how the grant will be dealt with in the financial statements if:

(i) the grant is treated as deferred income

(ii) the grant is deducted from the cost of the asset.

**Solution**

(a) The grant is £100,000 and the asset's depreciable amount is £190,000. The amount of the grant that should be recognised as income each year is calculated as follows:

(i) **Straight-line basis**

|  |  |  |
| --- | --- | --- |
| **year** | **Depreciation charge**  | **Grant recognised as income** |
| **1****2****3****4** | **47500****47500****47500****47500****190000** | **25000****25000****25000****25000****100000** |

Since the asset is depreciated on the straight-line basis, the grant is recognised

as income on the straight-line basis.

**(b)** **(i)**The grant of £100,000 is credited to a deferred income account and transferred in equal instalments to the statement of comprehensive income.

 The figures appearing in the statement of comprehensive income and in the statement of financial position are as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **2020** | **2021** | **2022** | **2023** |
| **Statement of comprehensive****Income**Depreciation chargeGrant income**Statement of financial****position**:Asset carrying amountDeferred income a/c | **47500****25000****202500****75000** | **47500****25000****155000****50000** | **47500****25000****107500****25000** | **47500****25000****60000****0** |

**(ii)** In this case, the cost of the asset (net of the grant) is £150,000. Residual value is £60,000, so depreciable amount is £90,000. This is written off as an expenseon the straight-line basis over the four years, as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **2020** | **2021** | **2022** | **2023** |
| **Statement of comprehensive****Income**Depreciation charge**Statement of financial position**Asset carrying amount | **22500****127500** | **22500****105000** | **22500****82500** | **22500****60000** |

**Case study: Government Grants**

ABC receives the following government grants in 20X2:

1. Grant of CU 40 000 to acquire a water cleaning station. The cost of the station was CU 100 000 and its useful life is 8 years. ABC acquired the station on 1 July 20X2 and recognized depreciation on a straight-line monthly basis.
2. Grant of CU 10 000 to cover the expenses for ecological measures during 20X2 – 20X5. ABC assumes to spend CU 3 000 in 20X2-20X5 and CU 2 000 in 20X6 (CU 14 000 in total).
3. Grant of CU 3 000 to cover the expenses for ecological measures made by ABC in 20X0-20X1.

**Required:Prepare the journal entries in the year ended 31 December 20X2**.

**– solution- Government grants:**

As there are 3 different grants

**1-Grant for a water cleaning station**

This grant is a typical grant to acquire property, plant and equipment. As written above, we have 2 choices to present it:

**Option #1: Deferred income**

ABC can credit the grant to deferred income and amortize it over the useful life of a water cleaning station in order to match the grant income with the relevant costs (in this case depreciation charges).

In 20X2, ABC recognizes ***CU 2 500 in profit or loss*** (calculated as the grant of CU 40 000 divided by 8 years times 6 months in 20X2 divided by 12 months in a year).

Our journal entries are:

|  |  |  |  |
| --- | --- | --- | --- |
| **Description** | **Amount** | **Debit** | **Credit** |
| Receipt of the grant | 40 000 | SoFP – Cash/Bank account | SoFP – Deferred income |
| Recognition in P/L in 20X2 | 2 500 (40 000/8\*6/12) | SoFP – Deferred income | P/L – Income from government grant |

**Option #2: Deduction from an asset**

ABC can deduct the grant amount to arrive at carrying amount of a water cleaning station. Then its recognition in profit or loss is automatically reflected in depreciation charges.

As a result, the new carrying amount of a water cleaning station upon initial recognition is CU 60 000 (cost of CU 100 000 less grant of CU 40 000) and the annual depreciation charge is CU 7 500 (CU 60 000 divided by 8) instead of CU 12 500 (CU 100 000 divided by 8). In the first year, it’s CU 3 750 (6 months only).

Our journal entries are:

|  |  |  |  |
| --- | --- | --- | --- |
| **Description** | **Amount** | **Debit** | **Credit** |
| Receipt of the grant | 40 000 | SoFP – Cash/Bank account | SoFP – PPE (Water cleaning station) |
| Recognition in P/L in 20X2 (within depreciation charge) | 3 750 (60 000/8\*6/12) | P/L – Depreciation of water cleaning station | SoFP – PPE (water cleaning station) |

Note: SoFP = statement of financial position.

**2-Grant for ecological measures in 20X2-20X5**

Apparently, the second grant is provided to reimburse the expenses for ecological measures in 20X2 to 20X5. In other words, it is a **grant for current and future expenses**.

ABC needs to recognize the income from grant in the periods when relevant expenses are incurred.

In this example, we can calculate the portion recognized in P/L in 20X2 on a proportionate basis, i.e. assumed CU 3 000 in 20X2 divided by total assumed expenses of CU 14 000 times the grant of CU 10 000.

The credit entry goes in profit or loss, but here, ABC has a choice to present the grant income as a separate line item (that’s easier) or to deduct it from the expenses.

The journal entries are:

|  |  |  |  |
| --- | --- | --- | --- |
| **Description** | **Amount** | **Debit** | **Credit** |
| Receipt of the grant | 10 000 | SoFP – Cash/Bank account | SoFP – Deferred income |
| Recognition in P/L in 20X2 | 2 143 (3 000/14 000\*10 000) | SoFP – Deferred income | P/L – Income from grants (or relevant expense) |

**Grant for ecological measures in 20X0-20X1**

**3-The third grand relates to the expenses that had already been incurred in the previous years 20X0 and 20X1**.
As a result, the grant is recognized immediately in profit or loss.

The journal entry is:

|  |  |  |  |
| --- | --- | --- | --- |
| **Description** | **Amount** | **Debit** | **Credit** |
| Receipt of the grant | 3 000 | SoFP – Cash/Bank account | P/L – Income from government grant |