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IAS® Standard 20 Accounting for Government Grants and Disclosure of Government Assistance

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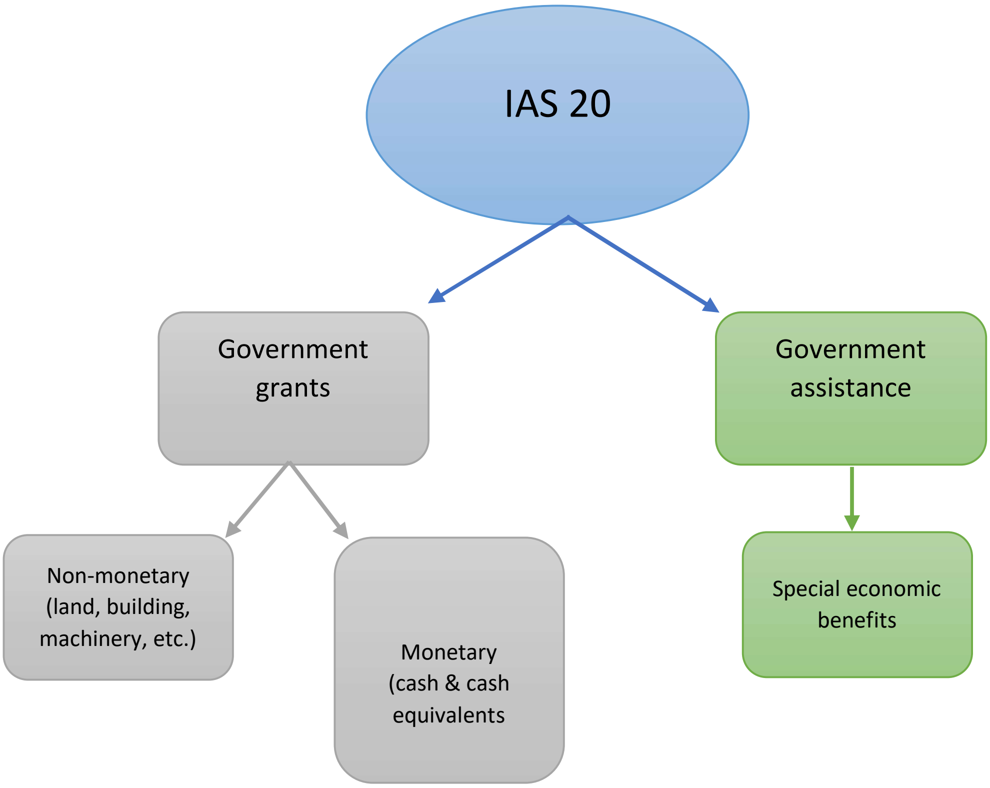
SCOPE AND KEY DEFINITIONS

Government grants are assistance made by the transfer of monetary (cash and cash equivalents) or non-monetary (land, building, machinery, etc.) resources to entities or other types of organisations. Another issue addressed in the standard, government assistance, are economic benefits provided by the government to entities. IAS 20 is a standard that concerns all entities benefiting from government grants. IAS 20 specifies not only accounting for government grants, but also financial statement disclosures related to these grants. Disclosures about other forms of government assistance are also included in this standard. Figure 1 gives the scope of IAS 20.

Figure 1. The Scope of IAS 20

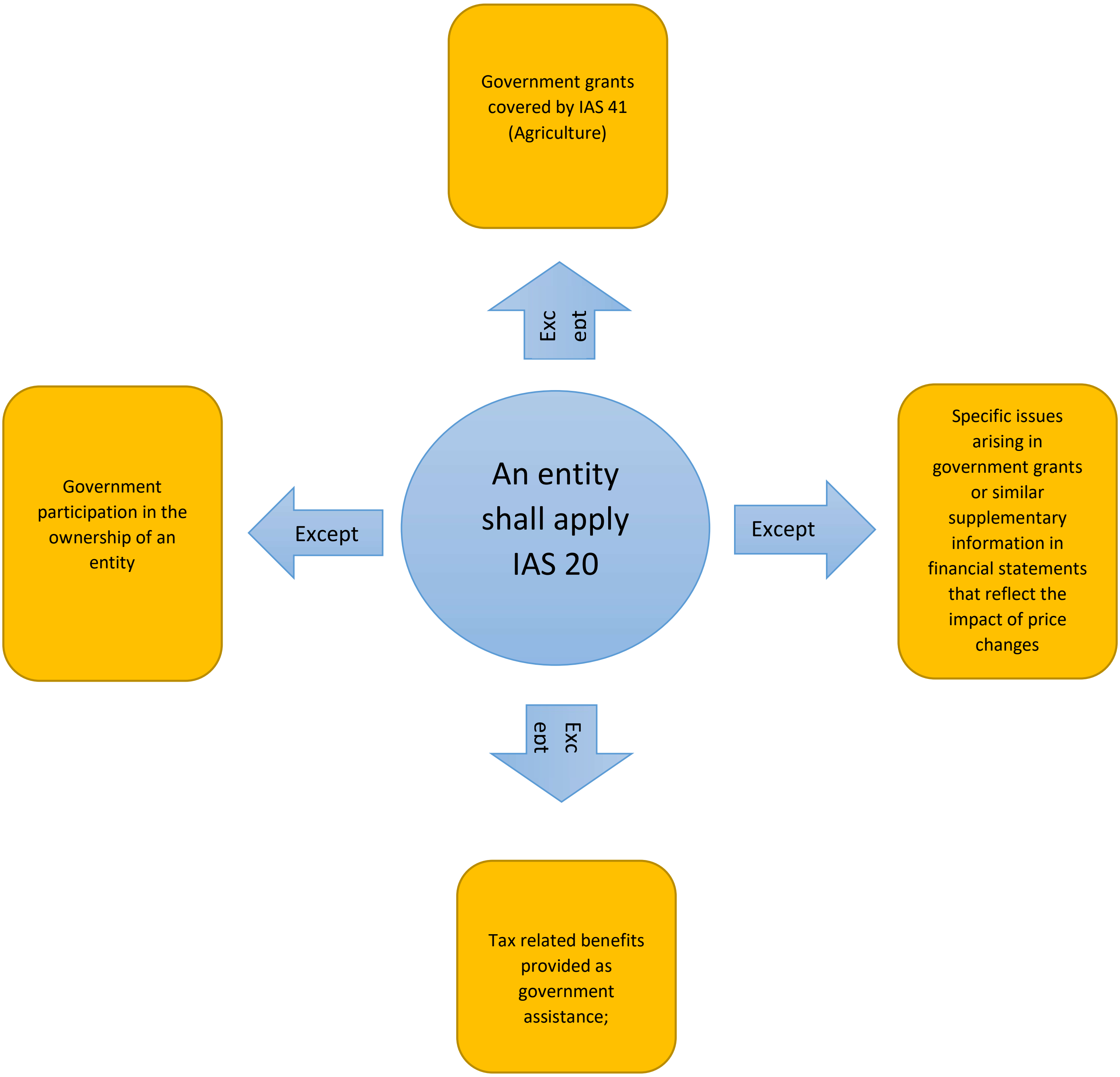


IAS 20 standard has four exclusions (IAS 20, 2). These are:

- Specific issues arising in government grants or similar supplementary information in financial statements that reflect the impact of price changes (covered by IAS Standard 29 Financial Reporting in Hyperinflationary Economies);
- Tax related benefits provided as government assistance (covered by IAS Standard 12 Income Taxes);
- Government participation in the ownership of an entity; and
- Government grants covered by IAS Standard 41 Agriculture.

Figure 2 shows exclusions from the scope of IAS 20.

Figure 2. Exclusions of IAS 20

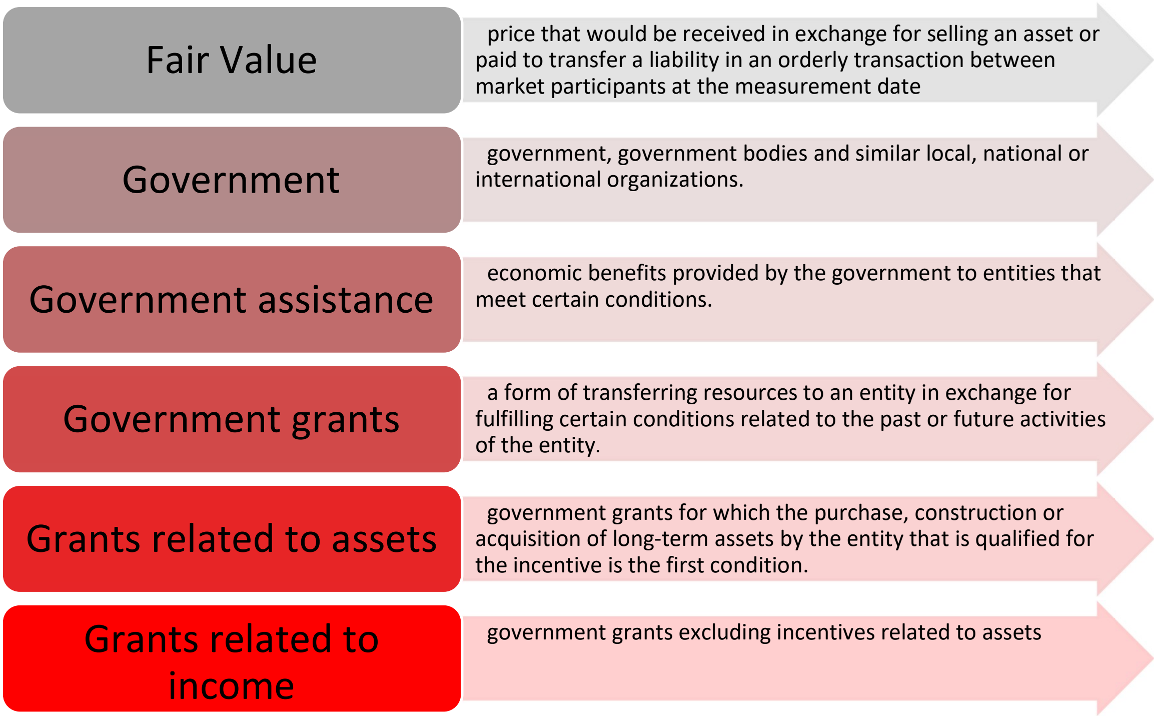


To understand this standard correctly, we must know some basic definitions such as fair value, government, government assistance, government grants, grants related to assets and grants related to income. Definitions of these terms in the standard are as follows (IAS 20, 3):

- Fair Value is the price that would be received in exchange for selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
- Government refers to the government, government bodies and similar local, national or international organisations.
- Government assistance are economic benefits provided by the government to entities that meet certain conditions.
- Government grants are a form of transferring resources to an entity in exchange for fulfilling certain conditions related to the past or future activities of the entity.
- Grants related to assets are government grants for which the purchase, construction or acquisition of long-term assets by the entity that is qualified for the incentive is the first condition. Such grants may include secondary conditions that limit the type, location, acquisition or holding period of the long-term asset.
- Grants related to income are government grants excluding incentives related to assets.

Figure 3 shows the definitions in IAS 20

Figure 3. Definitions in IAS 20



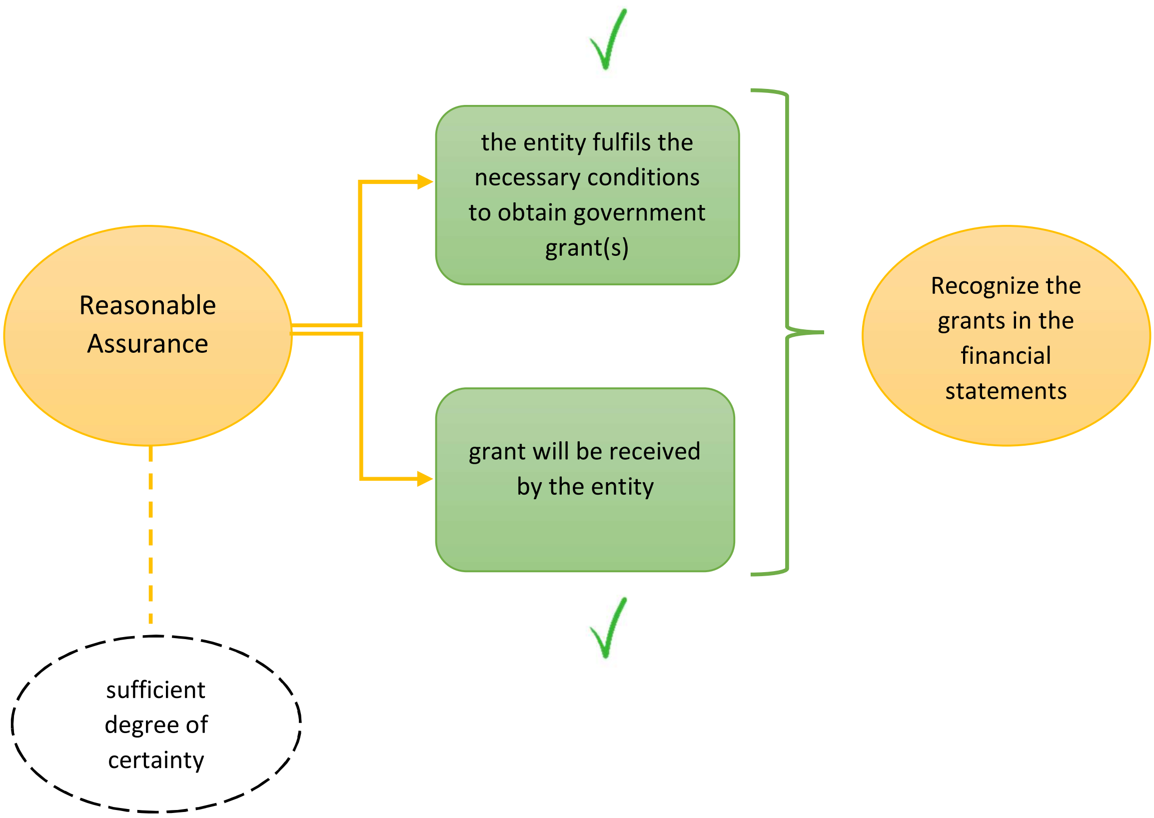
RECOGNITION

For government grants to be recognised in the financial statements, reasonable assurance must be provided on two conditions. These conditions are; the entity fulfils the necessary conditions to obtain government grant(s) and the grant will be received by the entity.

The definition of reasonable assurance is not explained in this standard, but one of the recognition criteria in the IFRS's conceptual framework is "sufficient degree of certainty". In this case, it can be accepted that reasonable assurance means sufficient degree of certainty.

There is a point to be careful about when deciding whether the two conditions mentioned above are met; receipt of a grant does not of itself provide conclusive evidence that the conditions attaching to the grant have been or will be fulfilled. Figure 4 gives the conditions to recognise the government grants in the financial statements.

Figure 4. Conditions to Recognise the Government Grants

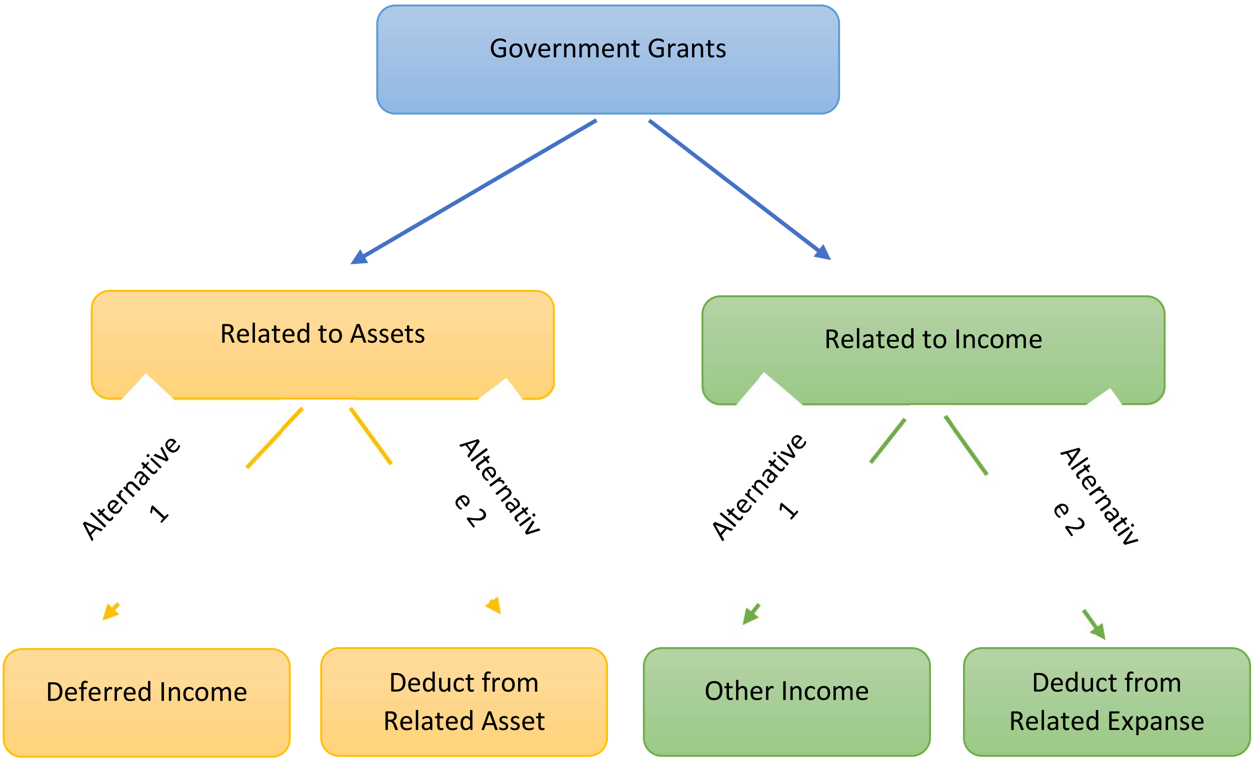


In the recognition of government grants, situations that also concern other standards may arise. After government grants are recognised in the financial statements, contingent assets, contingent liabilities and provisions related to these incentives should be accounted for in accordance with the IAS Standard 37: Provisions, Contingent Liabilities and Contingent Assets. If a low interest loan is taken as a government grant, the accounting treatment for this loan is carried out in accordance with the IFRS Standard 9: Financial Instruments.

<u>Accounting Treatment for Government Grants</u>

Accounting treatment for government grants differ according to the purpose of the grant. Government grants may be related to assets or income. Figure 5 summarises the types of government grants according to IAS 20.

Figure 5. Accounting Treatment of Government Grants According to IAS 20



<u>Government Grants Related to Assets</u>

Government grants related to assets must be presented in the statement of financial position. IAS 20 offers 2 alternatives for presentation of the government grants in the statement of financial position. These grants may be presented as deferred income or may be deducted from the book value of depreciable assets.

If the entity chooses the deferred income alternative, it recognises deferred income in profit or loss over the useful life of the asset.

If the entity prefers deducting the grants from the book value of the asset, depreciable amount of the asset will be reduced at the beginning of useful life. Thus, the depreciation expenses that will arise during the useful life of the asset will also be reduced. As a result of this, government grants will be indirectly recognised in profit or loss.

For example, an entity will receive a government grant for CU 90,000 for an equipment to be purchased. The cost of the equipment to be purchased is CU 130,000, its expected useful life is 3 years. The residual value of the equipment at the end of its useful life is expected to be CU 10.000. The entity will apply the straight-line method of depreciation on a monthly basis.

Yearly depreciation expense of the equipment will be CU 40.000. The residual value is subtracted from the book value of the asset and the remaining amount is divided by its useful life to calculate the amount of annual depreciation.

$$Yearly\ Depreciation = \frac{Book\ Value - Residual\ Value}{Useful\ Life} = \frac{CU\ 130{,}000 - CU\ 10{,}000}{3\ years} = CU\ 40{,}000$$

If the entity chooses a “deferred income” alternative, deferred income will be recognised in profit or loss throughout the useful life of the equipment. Recognition of income and depreciation expenses of equipment need to be compatible. This is because the amortisation expenses of the equipment are related to the government grants. The entity uses a straight line method of depreciation and depreciation expense will be recognised in the same amount each year. In this case, the income to be recognised in profit or loss will be the same in each year.

$$Yearly\ Amount\ of\ Income = \frac{CU\ 90{,}000}{3\ years} = CU\ 30{,}000$$

If the entity chooses the “deferred income” alternative, the journal entries for year 1 will be as follows:

Dr.	PP&E (ASSETS)	130,000	
Cr.	CASH		130,000
Dr.	BANK (ASSETS)	90,000	
Cr.	DEFERRED INCOME (LIABILITIES)		90,000
Dr.	DEPRECIATION EXPENSE – EQUIPMENT (P&L)	40,000	
Cr.	ACCUMULATED DEPRECIATION (ASSETS)		40,000
Dr.	DEFERRED INCOME (LIABILITIES)	30,000	
Cr.	OTHER INCOME – GOVERNMENT GRANTS (P&L)		30,000

If the entity deduct income from the book value of depreciable assets, the book value of the asset will decrease at the beginning of the investment. This will affect yearly depreciation expense, too.

The entity will subtract the government grant from the carrying amount of the asset and depreciate the remaining amount.

$$Book\ Value = Cost - Grant\ Amount = CU\ 130{,}000 - CU\ 90{,}000 = CU\ 40{,}000$$

The calculation of the annual depreciation amount will be the same as that of the deferred income alternative, but this time the depreciable amount is CU 30,000, not CU 120,000.

$$Yearly\ Depreciation = \frac{Book\ Value - Residual\ Value}{Useful\ Life} = \frac{CU\ 40{,}000 - CU\ 10{,}000}{3\ years} = CU\ 10{,}000$$

If the entity chooses the deduct from related asset alternative, the journal entries for year 1 will be as follows:

Dr.	PP&E (ASSETS)	130,000	
Cr.	BANK		130,000
Dr.	BANK (ASSETS)	90,000	
Cr.	PP&E (ASSETS)		90,000
Dr.	DEPRECIATION EXPENSE – EQUIPMENT (P&L)	10,000	
Cr.	ACCUMULATED DEPRECIATION (ASSETS)		10,000

The alternative chosen will not affect the profit or loss of the entity but will affect the presentation of the statement of financial position. Also total assets and total liabilities & owners’ equity will be affected. In the deferred income alternative, total assets and total liabilities & owners’ equity in the statement of financial position are higher than the other alternatives.

Statement of Financial Position
Beginning of Year 1
CU
(Deferred Income Alternative)

Assets		Lia.&OE	
PP&E	130,000	Deferred Income	90,000

Statement of Financial Position
Beginning of Year 1
CU
(Deduct From Related Asset Alternative)

Assets		Lia.&OE	
PP&E	40,000	Deferred Income	-

Statement of Financial Position
End of Year 1
CU
(Deferred Income Alternative)

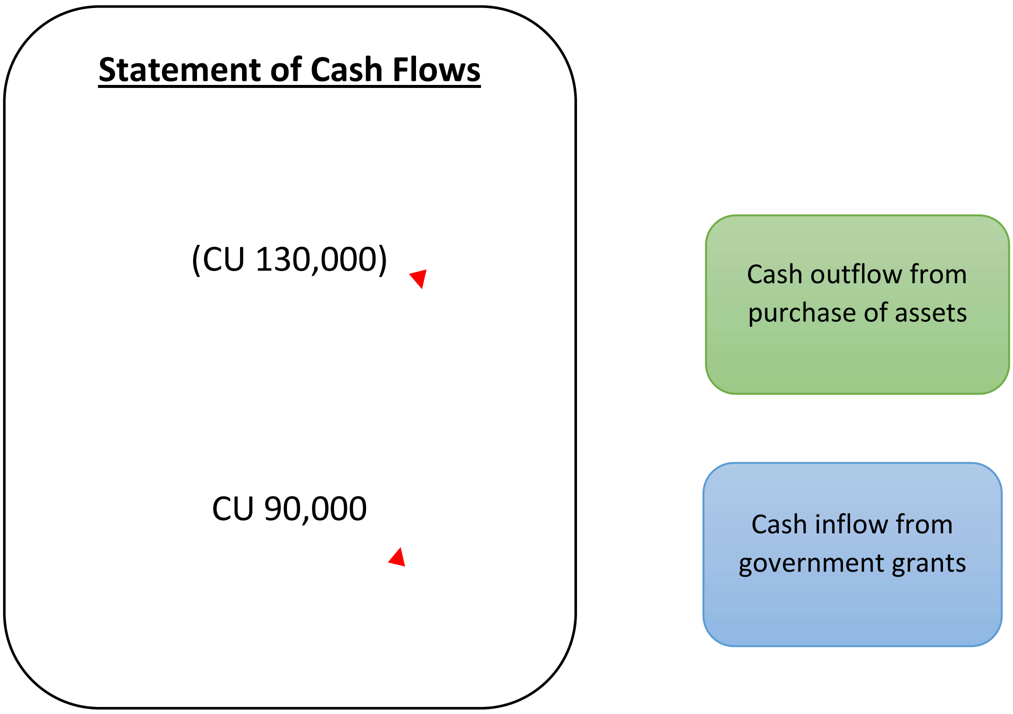
Assets		Lia.&OE	
PP&E	130,000	Deferred Income	60,000
Acc.Dep.	(40,000)		

Statement of Financial Position
End of Year 1
CU
(Deduct From Related Asset Alternative)

Assets		Lia.&OE	
PP&E	40,000	Deferred Income	-
Acc.Dep.	(10,000)		

Cash inflows from government grants should be presented separately in the statement of cash flow. Thus, it is possible to present how much of the cash outflow related to the purchase of assets is met by government grants. Figure 6 shows the presentation of government grants in the statement of cash flow.

Figure 6. Presentation of Government Grants in the Statement of Cash Flow



Government Grants Related to Income

As stated earlier, government grants are either related to assets or to income. if the government grants received by the entity are related to income, these grants must be presented in the statement profit or loss. There are two alternatives; the first one is reporting the grant as an "other income" and the second alternative is deducting from related expenses. Both alternatives are accepted by IAS 20.

For example, an entity received a government grant of CU 1,000,000 to cover environmental costs over a period of three years. Environmental costs for the next three years are CU 200,000, CU 800,000 and CU 600,000, respectively.

Year	Costs
1	CU 200,000
2	CU 800,000
3	CU 600,000
Total	**CU 1,600,000**

According to IAS 20, the government grants received should be systematically matched with the costs associated with it. In this case, the government grants obtained can be allocated over the years in a manner that matches with yearly environmental expenses.

Year	Costs	Ratio of Annual Cost to Total Cost	Grants Recognised by Year
1	CU 200,000	CU 200,000/CU 1,600,000 = **0.125**	0.125 * CU 1,000,000 = **CU 125,000**
2	CU 800,000	CU 800,000/CU 1,600,000 = **0.50**	0.50 * CU 1,000,000 = **CU 500,000**
3	CU 600,000	CU 600,000/CU 1,600,000 = **0.375**	0.375 * CU 1,000,000 = **CU 375,000**
Total	**CU 1,600,000**	**1.00**	**CU 1,000,000**

First, the ratio of annual expenses to total expenses is calculated. In the second step, the total grant amount is multiplied by the annual rates of expenses. Thus, the income related to expense will be calculated for each year.

If the entity uses the “other income” alternative, the journal entries for year 1 will be as follows:

Dr.	BANK (ASSETS)	1,000,000	
Cr.	DEFERRED INCOME (LIABILITIES)		1,000,000
Dr.	ENVIRONMENTAL EXPENSES (P&L)	200,000	
Cr.	BANK (ASSETS)		200,000
Dr.	DEFERRED INCOME (LIABILITIES)	125,000	
Cr.	OTHER INCOME – GOVERNMENT GRANTS (P&L)		125,000

If the entity uses the deduct from related expenses alternative, the journal entries for year 1 will be as follows:

Dr.	BANK (ASSETS)	1,000,000	
Cr.	DEFERRED INCOME (LIABILITIES)		1,000,000
Dr.	ENVIRONMENTAL EXPENSES (P&L)	200,000	
Cr.	BANK (ASSETS)		200,000
Dr.	DEFERRED INCOME (LIABILITIES)	125,000	
Cr.	ENVIRONMENTAL EXPENSES (P&L)		125,000

The alternative chosen will not affect the result of the statement of profit and loss, but the presentation of the statement will be changed.

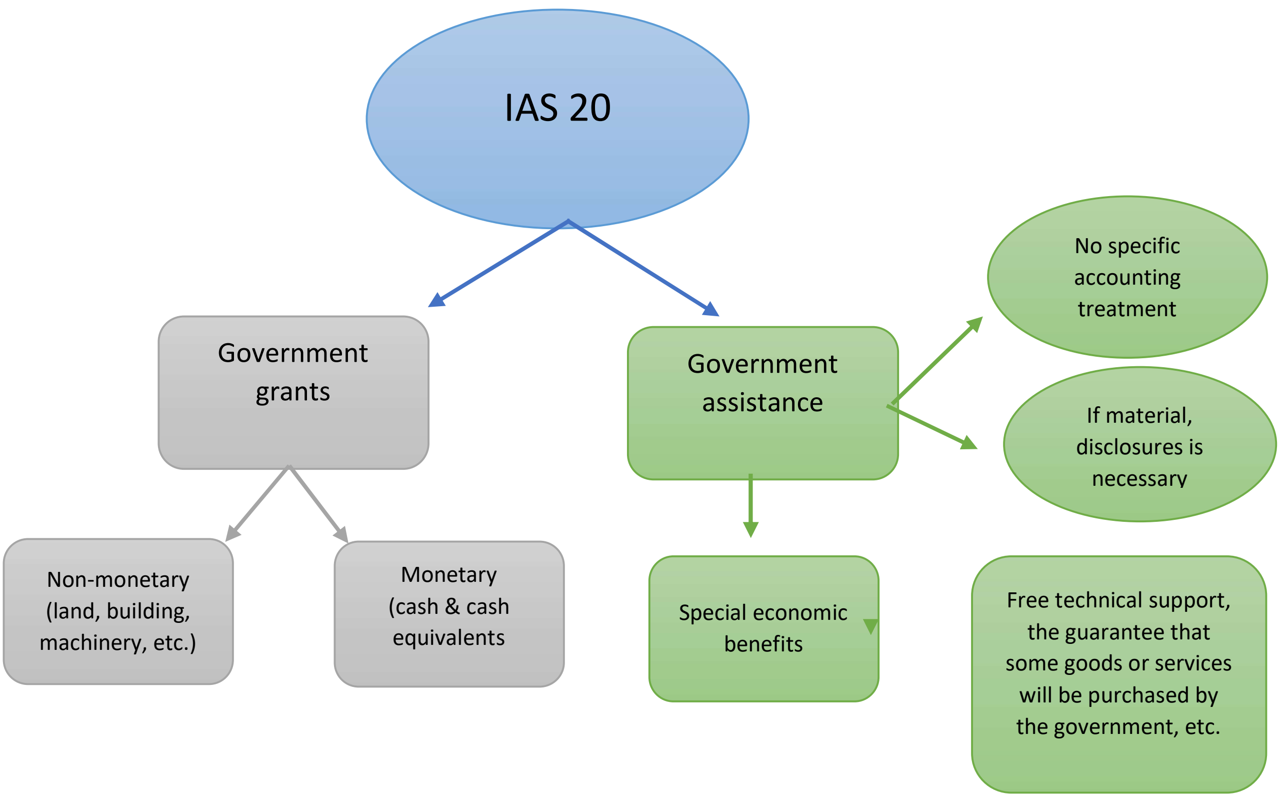
Statement of Profit & Loss (Year 1) CU Other Income Alternative		Statement of Profit & Loss (Year 1) CU Deduct From Related Expense Alternative	
<u>Operating Expenses</u>		<u>Operating Expenses</u>	
Environmental Expenses	(200,000)	Environmental Expenses	(75,000)
<u>Other Income</u>		<u>Other Income</u>	
Government Grants	125,000	-	

In the other income alternative, both the environmental expenses account and the other income accounts are used. When deducting the expense alternative is chosen, only the environmental expense account will be used. However, this time, the amounts recognised in the environmental expenses account will be less than the first alternative.

<u>Government Assistance</u>

Government assistance are actions that provide special economic benefits to entities if certain criteria are met. No value can be attributed to such assistance and is indistinguishable from ordinary business activities. Free technical support is an example of help the value of which cannot be determined. The guarantee that some goods or services of the entity will be purchased by the government is also an example of government assistance that cannot be separated from ordinary business activities. There is no specific accounting treatment for such assistance as its value cannot be determined and cannot be separated from normal operations. If such assistance is material, the type, scope and duration should be disclosed in the disclosures of the financial statements. Figure 7 summarises government grants and government assistance.

Figure 7. Summary of Government Grants and Government Assistance



DISCLOSURES

There is information that must be disclosed in the disclosures of the financial statements of the entities that receive government grants or government assistance. These are (IAS 20, 39);

- Accounting policies adopted for government grants. Also the method of presentation of these grants in the statements must be disclosed (presentation as deferred income or deducted from book value of the asset);
- Type, amount and duration of government grants and other government assistances the entity directly benefits from and
- Conditions that are not fulfilled for government assistance that are reported in the financial statements and other conditions.

RECAPITULATIVE EXAMPLE

At the beginning of 2021 an entity purchased a plant for CU 500,000. Its expected useful life is 10 years. The residual value of the plant at the end of its useful life is expected to be zero. The entity will apply the straight-line method of depreciation. The entity received a government grant of CU 400,000.

Required:

a) Prepare the journal entries for 2021 and show the effect on the statement of financial position and statement of profit & loss using the deferred income alternative.

b) Prepare the journal entries for 2021 and show the effect on the statement of financial position and statement of profit & loss deduct from related asset alternatives.

a) Deferred Income Method

If the entity chooses deferred income alternative, yearly depreciation expense of the equipment will be CU 50.000.

$$Yearly\ Depreciation = \frac{Book\ Value - Residual\ Value}{Useful\ Life} = \frac{CU\ 500.000 - 0}{10\ years} = CU\ 50{,}000$$

deferred income will be recognised in profit or loss throughout the useful life of the plant.

$$Yearly\ Amount\ of\ Income = \frac{CU\ 400{,}000}{10\ years} = CU\ 40{,}000$$

If the entity chooses the deferred income alternative, the journal entries for 2021 will be as follows:

Dr.	PROPERTY, PLANT&EQUIPMENT (ASSETS)	500,000	
Cr.	BANK		500,000
Dr.	BANK (ASSETS)	400,000	
Cr.	DEFERRED INCOME (LIABILITIES)		400,000
Dr.	DEPRECIATION EXPENSE – EQUIPMENT (P&L)	50,000	
Cr.	ACCUMULATED DEPRECIATION (ASSETS)		50,000
Dr.	DEFERRED INCOME (LIABILITIES)	40,000	
Cr.	OTHER INCOME – GOVERNMENT GRANTS (P&L)		40,000

The statement of financial position at the end of 2021 and the statement of profit & loss for 2021 will be as follows:

Statement of Financial Position At the End of 2021 CU (Deferred Income Alternative)			
Assets			**Lia.&OE**
PP&E	500,000	Deferred Income	360,000
Acc.Dep.	(50,000)		

Statement of Profit & Loss (2021) CU (Deferred Income Alternative)	
Operating Expenses	
Depreciation Expenses	(50,000)
Other Income	
Government Grants	40,000

The entity recognized CU 40,000 income from government grants in the statement of profit or loss in 2021. Also, there is CU 360.000 deferred income in the statement of financial position at the end of 2021.

b) Deduct From Related Assets Alternative

If the entity prefers deducting income from the book value of depreciable assets, this will affect the book value of the asset and depreciation expenses.

The entity will subtract the government grant from the carrying amount of the asset and depreciate the remaining amount.

$$Book\ Value = Cost - Grant\ Amount = CU\ 500{,}000 - CU\ 400{,}000 = CU\ 100{,}000$$

The yearly depreciation expense of the equipment will be CU 10,000.

$$Yearly\ Depreciation = \frac{Book\ Value - Residual\ Value}{Useful\ Life} = \frac{CU\ 100{,}000 - 0}{10\ years} = CU\ 10{,}000$$

If the entity prefers the deduct from the related asset alternative, the journal entries for 2021 will be as follows:

Dr.	PROPERTY, PLANT&EQUIPMENT (ASSETS)	500,000	
Cr.	BANK (ASSETS)		500,000
Dr.	BANK (ASSETS)	400,000	
Cr.	PROPERTY, PLANT&EQUIPMENT (ASSETS)		400,000
Dr.	DEPRECIATION EXPENSE – EQUIPMENT (P&L)	10,000	
Cr.	ACCUMULATED DEPRECIATION (ASSETS)		10,000

The statement of financial position at the end of 2021 and the statement of profit & loss for 2021 will be as follows:

Statement of Financial Position At the End of 2021 CU		
Assets	**(Deduct From Related Asset Alternative)**	**Lia.&OE**
PP&E	100,000	
Acc.Dep.	(10,000)	

Statement of Profit & Loss (2021) CU (Deduct From Related Asset Alternative)	
Operating Expenses	
Depreciation Expenses	(10,000)
Other Income	
Government Grants	-

The entity recognized CU 10,000 depreciation expense in the statement of profit or loss in 2021. Also, there is CU 10.000 accumulated depreciation in the statement of financial position at the end of 2021.