2009

IFRS Foundation: Training Material for the *IFRS*® *for SMEs*

Module 24 – Government Grants

IFRS Foundation: Training Material for the *IFRS® for SMEs*

including the full text of
Section 24 *Government Grants*
of the International Financial Reporting Standard (IFRS)
for Small and Medium-sized Entities (SMEs)
issued by the International Accounting Standards Board on 9 July 2009

with extensive explanations, self-assessment questions and case studies

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This training material has been prepared by IFRS Foundation education staff and has not been approved by the International Accounting Standards Board (IASB). The accounting requirements applicable to small and medium-sized entities (SMEs) are set out in the *International Financial Reporting Standard (IFRS) for SMEs*, which was issued by the IASB in July 2009.

INTRODUCTION

This module focuses on the accounting and disclosure of government grants and other forms of government assistance in accordance with Section 24 *Government Grants* of the *International Financial Reporting Standard (IFRS) for Small and Medium-sized Entities (SMEs)*. It introduces the learner to the subject, guides the learner through the official text, develops the learner's understanding of the requirements through the use of examples and indicates significant judgements that are required in accounting for government grants. Furthermore, the module includes questions designed to test the learner's knowledge of the requirements and case studies to develop the learner's capabilities to account for government grants in accordance with the *IFRS for SMEs*.

Learning objectives

Upon successful completion of this module you should know when and how to apply the financial reporting requirements for government grants in accordance with the *IFRS for SMEs*. Furthermore, through the completion of case studies that simulate aspects of the real world application of that knowledge, you should be able to apply those financial reporting requirements in practice. In particular you should, in the context of the *IFRS for SMEs*, be able:

- to distinguish government grants from other forms of government assistance and from other forms of income
- to identify when a government grant qualifies for recognition in income
- to measure government grants
- to present and disclose government grants in financial statements
- to identify and disclose other forms of government assistance
- to demonstrate an understanding of significant judgements that are required in accounting for government grants.

Module 24 – Government Grants

IFRS for SMEs

The *IFRS for SMEs* is intended to apply to the general purpose financial statements of entities that do not have public accountability (see Section 1 *Small and Medium-sized Entities*).

The *IFRS for SMEs* includes mandatory requirements and other material (non-mandatory) that is published with it.

The material that is not mandatory includes:

- a preface, which provides a general introduction to the *IFRS for SMEs* and explains its purpose, structure and authority.
- implementation guidance, which includes illustrative financial statements and a disclosure checklist.
- the Basis for Conclusions, which summarises the IASB's main considerations in reaching its conclusions in the *IFRS for SMEs*.
- the dissenting opinion of an IASB member who did not agree with the publication of the *IFRS for SMEs*.

In the *IFRS for SMEs* the Glossary is part of the mandatory requirements.

In the *IFRS for SMEs* there are appendices in Section 21 *Provisions and Contingencies*, Section 22 *Liabilities and Equity* and Section 23 *Revenue.* Those appendices are non-mandatory guidance.

Introduction to the requirements

The objective of general purpose financial statements of a small and medium-sized entity is to provide information about the financial position, financial performance and cash flows of the entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs.

The objective of Section 24 *Government Grants* is to prescribe the accounting and reporting for government grants and the disclosure of other forms of government assistance.

An entity shall recognise government grants as follows:

(a) a grant that does not impose specified future performance conditions on the recipient is recognised in income when the grant proceeds are receivable;

(b) a grant that imposes specified future performance conditions on the recipient is recognised in income only when the performance conditions are met;

(c) grants received before the income recognition criteria are satisfied are recognised as a liability.

Furthermore, an entity must measure government grants at the fair value of the asset received or receivable.

The section also requires an entity to provide specified disclosures about its government grants and an indication of other forms of government assistance from which it has directly benefited.

Module 24 – Government Grants

REQUIREMENTS AND EXAMPLES

The contents of Section 24 *Government Grants* of the *IFRS for SMEs* are set out below and shaded grey. Terms defined in the Glossary of the *IFRS for SMEs* are also part of the requirements. Those terms are in **bold type** the first time they appear in the text of Section 24. The notes and examples inserted by the IFRS Foundation education staff are not shaded.
Other annotations inserted by the IFRS Foundation staff are presented within square brackets in ***bold italics***. The insertions made by the staff do not form part of the *IFRS for SMEs* and have not been approved by the IASB.

Scope of this section

24.1 This section specifies the accounting for all government grants. A **government grant** is assistance by government in the form of a transfer of resources to an entity in return for past or future compliance with specified conditions relating to the operating activities of the entity.

Notes

The term 'government' includes government, government agencies and similar bodies whether local, national or international. By analogy, grants received from non-governmental development agencies are accounted for similarly to government grants. Such agencies provide economic assistance and include local, regional, national or international agencies and authorities.

Government grants are sometimes called by other names such as subsidies, subventions or premiums. They can take many forms varying both in the nature of the resources transferred to an entity and in the conditions that are usually attached to it.
The purpose of the grant may be to encourage an entity to embark on a course of action that it would not normally have taken if the assistance was not provided.

If a government transfers resources to an entity in exchange for an equity interest in the entity, that is not a government grant even if the government imposes specific conditions relating to the operating activities of the entity in conjunction with the transaction. The same would be true for a government loan to an entity. However, the benefit of a government loan at no interest or at a below market rate of interest is treated as a government grant.

A government grant is an entity-specific transfer of resources. Resources that are made available by a government to a wide range of entities, such as the right to use public roads or other infrastructure, do not constitute a government grant under Section 24.

In some countries government assistance to entities aims to encourage or support 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 government to entities that:

- operate in a particular industry;

- continue operating in recently privatised industries; or
- start or continue to run their business in underdeveloped areas.

Such government assistance is a government grant. A general requirement to operate in particular regions or industry sectors in order to qualify for the government assistance constitutes a condition as specified in paragraph 24.1. Therefore, the requirements of Section 24 regarding government grants apply.

Examples – government grants

Ex 1 **On 1 January 20X7, as part of a scheme to provide support for projects to help rural communities, the government announced a plan whereby during 20X7–20X9 entities can apply for a grant to set up farming operations in a specified rural area. Qualifying entities will receive an upfront cash payment of CU50,000[1] to set up farming operations in the specified area. Entities must complete an application form, submit their proposal and provide specified documents which the government will consider before issuing the grant.**

The upfront cash payment from the government to a qualifying entity is a government grant to that entity. Usually the entity will need to comply with specified conditions regarding the establishment and the operation of the farm in order to obtain and retain the grant.

Ex 2 **Entity A is a manufacturer of medical devices. In 20X7 it successfully applied for financial support from the local government to fund research into a particular new type of technology that could lead to a significant improvement in healthcare. The local government agrees to reimburse entity A 50 per cent of specified project costs over a two-year period. In accordance with the agreement, entity A must meet specified targets with regards to testing of the technologies being developed. The entity must also prepare six-monthly progress reports for the government. If targets are met and progress is considered successful the government is likely to provide further support in the future.**

The refund of a portion (50 per cent) of the qualifying project costs by the government is a government grant. Usually the entity will need to comply with strict conditions (eg providing six-monthly reports and meeting milestones) and only specified project costs would qualify for reimbursement in accordance with the government grant scheme.

Ex 3 **To encourage entities to expand their operations in a specified development zone, where it is difficult for entities to obtain financing for their projects, the local government has offered entities interest free loans for a five-year period. In accordance with the local government scheme, entity B received a five-year interest-free loan from the local government to fund the expansion of its cloth manufacturing plant.**

The interest-free element of the loan is a government grant. It is a transfer of a resource from the government to entity B since the entity does not need to pay interest at market

[1] In this example, and in all other examples in this module, monetary amounts are denominated in 'currency units (CU)'.

rates and the government is forgoing interest income at market rates. The specified conditions that the entity B must comply with are that the loan proceeds must be used to fund the planned expansion of the business. Only the interest element is recognised as a government grant. The capital amount of the loan (ie excluding the interest-free element) is not a government grant.

Ex 4 **In 20X7 an entity received from a national government, free of charge, a non-transferable licence to catch 10 tonnes of fish per year for each of the next five years, in that jurisdiction's waters. The licence is issued to the entity to prevent overfishing in the jurisdiction's waters. Under the licence the entity is not allowed to catch more than 10 tonnes of fish in a particular year or it will be fined severely.**

The transfer of the fishing licence from the government to the entity is a government grant. The resource transferred is the non-transferable right to remove 10 tonnes of fish per year from that jurisdiction's waters for each of the next five years. It is received in return for future compliance with specified conditions relating to the operating activities of the entity (ie the condition is that during that five-year period the entity must not catch more than 10 tonnes of fish in a particular year).

Ex 5 **The facts are the same as in example 4. However, in this example, the licence is transferable in full or in part. For example, if the entity plans to catch only 6 tonnes of fish per year it may sell the right to catch the remaining 4 tonnes of fish to another fishing entity.**

The transfer of the fishing licence from the government to the entity is a government grant. The resource transferred is the transferable right to remove 10 tonnes of fish per year from that jurisdiction's waters for each of the next five years. It is received in return for future compliance with specified conditions relating to the operating activities of the entity (ie the condition is that during that five-year period the entity must not catch, or transfer to another the right to catch, more than 10 tonnes of fish in a particular year).

Ex 6 **On 31 December 20X7 an entity received CU400,000 from a national government for not cultivating 40 acres of its land during 20X7.**

The transfer of the CU40,000 is a government grant—it is a resource transferred to the entity from a government in return for past compliance with specified conditions relating to the agricultural activities of the entity.

Ex 7 **The facts are the same as in example 6. However, in this example, the entity received the funds from the governing body of the regional economic union in which the entity operates.**

The transfer of the CU40,000 is a government grant—it is a resource transferred to the entity from a government in return for past compliance with specified conditions relating to the agricultural activities of the entity.

Ex 8 **A national government develops a scheme to encourage reductions in greenhouse gas emissions. A government agency issues rights (allowances), free of charge, to participating entities to emit a specified level of greenhouse gases. Participating**

entities in the scheme are able to buy and sell allowances. There is an active market for trading in the allowances. At the end of a specified period, participating entities are required to deliver allowances equal to their actual emissions.

The issue of the greenhouse gas emission allowances by the government agency to an entity is a government grant—it is a transfer of resources (allowances) to an entity in return for compliance with specified conditions (emission levels) relating to its operating activities.

Examples – not government grants

Ex 9 **The facts are the same as in example 4. However, in this example the licence is not free—it is acquired in an unrestricted and public competitive bidding process.**

The issue of the fishing licence from the government to the entity is not a government grant. Although the winning bidder must comply with the conditions in the public bidding document, this is a business licence and not a government grant.

Ex 10 **A local government decided to privatise its ambulance service and published its criteria in a public bidding document. The entity that won the bid has an exclusive licence to provide ambulance services in the jurisdiction for a five-year period and will earn revenue from the fees it charges.**

The transfer of the licence is not a government grant. Although the winning bidder must comply with the conditions in the public bidding document, this is a business licence and not a government grant.

Ex 11 **In 20X7 an entity received, free of charge, a licence to catch 1,000 kilograms of fish per year for each of the next five years, in a local lake from the lake's private owner.**

The transfer of the fishing licence is not a government grant—it was not received from a government.

Ex 12 **In 20X7 the entity transported its goods by truck on roads provided by the national government. The roads are available to all free of charge.**

The right to transport the entity's goods by road in that jurisdiction is not a government grant, even though it may provide a significant benefit to the entity—the resource (free road use) is available to all in that jurisdiction (ie it is not given in return for compliance with specified conditions relating to the operating activities of the entity).

Ex 13 **In 20X7 the entity received electricity from a government agency at a lower rate per kilowatt than is available in neighbouring countries. The government agency is, by law, the only supplier of electricity in the country. It supplies electricity to all users of electricity in that jurisdiction at the same price.**

The inexpensive electricity received by the entity is not a government grant—the resource (inexpensive electricity) is available to all electricity users in that jurisdiction at the same rate (ie it is not given in return for compliance with specified conditions relating to the operating activities of the entity).

24.2 Government grants exclude those forms of government assistance that cannot reasonably have a value placed upon them and transactions with government that cannot be distinguished from the normal trading transactions of the entity.

Example – is not a government grant

Ex 14 **In 20X7 an entity provided catering and cleaning services to the government under a contract that produced 30 per cent of its annual revenue. The entity provides services to the government at a similar rate to its other large customers.**

The provision of catering and cleaning services to the government is a normal trading transaction of the entity and there is no government grant. Such income will be accounted for as revenue arising from the rendering of services in accordance with Section 23 *Revenue*.

Example 24.2 – is a government grant

Ex 15 **In 20X7 an entity provided catering and cleaning services to the government under a contract that produced 30 per cent of its revenue for the year. The government uses the services of this particular entity on the condition that at least one-third of the entity's workforce comprises adults with physical disabilities. The entity provides services to the government at a premium rate compared with its other large customers.**

The premium paid by the government over the normal market rate is a government grant. It is a transfer of resources to the entity in return for compliance with conditions relating to the employment of disabled employees. Only the premium (excess) over the market rate would be treated as a government grant.

24.3 This section does not cover 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. Section 29 *Income Tax* covers accounting for taxes based on income.

Examples – government assistance in Section 29 *Income Tax*

Ex 16 **In 20X7 the entity erected a factory building in a specified development zone. In accordance with a government incentive scheme designed to encourage investment in manufacturing capacity in a development zone, the entity was granted an immediate write-off of the cost of the building in the determination of its taxable income for the year ended 31 December 20X7.**

Outside of the development zone, depreciation of factory buildings is recognised as an expense in the determination of taxable profit on the straight-line basis over forty years.

The entity depreciates the building on the straight-line basis over its estimated useful life of 50 years to a nil residual value (see Section 17 *Property, Plant and Equipment*).

The government assistance (ie accelerated tax allowance) is not accounted for as a government grant. It is accounted for in accordance with Section 29 *Income Tax*.

Ex 17 **The facts are the same as in example 16. However, in this example, the entity is entitled to write off 150 per cent of the cost of the building immediately in the determination of its taxable income for the year ended 31 December 20X7.**

The government assistance (ie immediate tax deduction equal to 150 per cent of the cost of the factory building) is not accounted for as a government grant. It is accounted for in accordance with Section 29 *Income Tax*.

Ex 18 **The facts are the same as in example 16. However, in this example, instead of an accelerated tax allowance, the entity is entitled to a tax holiday for the tax years ended 31 December 20X7 and 20X8 (ie the entity is not required to pay income tax on what would otherwise be its taxable income for the years ended 31 December 20X7 and 20X8).**

The government assistance (ie tax holiday) is not accounted for as a government grant. It is accounted for in accordance with Section 29 *Income Tax*.

Ex 19 **The facts are the same as in example 16. However, in this example, instead of an accelerated tax allowance, the entity is entitled to pay tax at a lower rate (ie 20 per cent instead of 40 per cent) for the tax years ended 31 December 20X7 and 20X8.**

The government assistance (ie reduced tax rate) is not accounted for as a government grant. It is accounted for in accordance with Section 29 *Income Tax*.

Recognition and measurement

24.4 An entity shall recognise government grants as follows:

(a) A grant that does not impose specified future performance conditions on the recipient is recognised in income when the grant proceeds are receivable.

(b) A grant that imposes specified future performance conditions on the recipient is recognised in income only when the performance conditions are met.

(c) Grants received before the revenue recognition criteria are satisfied are recognised as a liability.

Notes

A performance condition is a requirement that entitles a government to the return of the granted resource if a specified event either occurs or does not occur. Any such requirement should have commercial substance to be regarded as a performance condition.

Examples – recognition

Ex 20 **In 20X7 the entity received from a national government, free of charge, a transferable licence to catch 100 tonnes of fish per year for each of the next five years, in that jurisdiction's waters. If the entity catches more than 100 tonnes of fish in a particular year, the five-year licence will not be revoked, however, the entity will need to pay a severe fine.**

The government grant—the grant of the transferable fishing licence—must be recognised as income in the profit or loss of the period in which it become receivable. Since the licence will not be revoked (there are no future performance conditions), recognition is likely to be on the date in 20X7 on which the fishing licence was granted to the entity by the national government (see paragraph 24.4(a)).

The licence is an intangible asset that should be recognised in the financial statements in accordance with Section 18 *Intangible Assets other than Goodwill*.

If, and only if, the entity catches more than 100 tonnes of fish must the entity recognise a provision to pay the fine in accordance with Section 21 *Provisions and Contingencies*.

Ex 21 **The facts are the same as in example 20. However, in this example, the grant of the licence is conditional upon the entity obtaining certification as meeting particular environmental conditions before starting to fish. Certification requires the entity to replace all nets with dolphin-friendly fishing nets, to ensure that boat engines meet strict safety requirements etc. The licence was conditionally awarded to the entity on 1 January 20X7.**

On 2 February 20X7 the entity was certified as in compliance with the environmental conditions.

The conditional grant of the transferable fishing licence is a government grant. On 1 January 20X7 the entity must recognise the fair value of the conditional licence received by way of a government grant (see paragraph 24.5) as a liability and the conditional licence received as an asset (see paragraph 24.4(c)).

The grant of the transferable fishing licence must be recognised as income in profit and loss when the performance conditions are met. The performance conditions were met on 2 February 20X7 when the entity was certified as compliant with the environmental conditions (see paragraph 24.4(b)).

The licence is an intangible asset that should be accounted for in accordance with Section 18.

Ex 22 **The facts are the same as in example 20. However, in this example, assume that the grant of the licence for years 2–5 of the licence period is conditional upon the entity continuing to meet particular environmental conditions throughout the preceding year. The five-year licence was conditionally awarded to the entity on 1 January 20X7. If the entity exceeds the quota in any given year or fails to meet the environmental conditions, the licence will be revoked at the end of that year. The government has recently set up tough monitoring restrictions to ensure that environmental conditions are met and that fishing quotas are not exceeded.**

In each year of the licence period the entity caught less than 100 tonnes of fish.

The government grant—the conditional grant of the transferable fishing licence—must be recognised in income when the performance conditions are met. On 1 January 20X7, one fifth of the value of the initial total grant should be recognised in income (as there are no performance conditions attached to the first year of the licence) (see paragraph 24.4(a)) and four-fifths should be recognised as a liability (see paragraph 24.4(c)). The licence is an intangible asset that should be recognised in the financial statements in accordance with Section 18.

At the end of 20X7 less than 100 tonnes of fish have been caught and the environmental conditions are met (ie the performance conditions have been satisfied for the part of the licence that relates to 20X8), the entity must derecognise one-fourth of the liability (ie an amount equal to one-fifth of the value of the initial grant) and recognise that amount in income (see paragraph 24.4(b)). The same amount will be recognised in income in each of the next three years provided that the entity catches less than 100 tonnes of fish and meets the environmental conditions (see paragraph 24.4(b)).

Note, even if the entity did not need to meet the environmental conditions, the requirement not to exceed the quota is a condition that has commercial substance and therefore requires recognition of grant income to be deferred in its own right.

Ex 23 **On 1 January 20X7 an entity received CU500,000 from a national government as an incentive to establish a manufacturing plant in particular location—a designated development zone. The incentive is conditional on the plant being erected in the development zone, meeting certain specifications (including environment and safety criteria) and starting commercial production on or before 31 December 20X8. If these conditions are not met, the entity will be liable to refund the entire CU500,000 to the national government.**

All the performance conditions were satisfied on 30 March 20X8 when the entity began commercial production at the plant.

The CU500,000 government grant received must be recognised as a liability on 1 January 20X7 (ie debit cash and credit liability) (see paragraph 24.4(c)). On 31 March 20X8, the CU500,000 government grant must be recognised in income and the liability must be derecognised (debit liability and credit income) (see paragraph 24.4(b)).

Notes:

It is not appropriate to reduce the carrying amount of the plant by the CU500,000 government grant.

Maintaining a level of employment is not an uncommon grant condition. If there was an additional condition that employment be kept at a certain level for a period of three years from 30 March 20X8, the grant will instead be recognised as income over the three years, as the condition is satisfied. When the condition is satisfied depends on the terms of the condition. If the condition requires the full amount of the grant to be repaid if at any time during the three-year period the employment condition is breached, then the grant cannot be recognised in profit or loss until the condition is satisfied (ie at the end of the three-year period provided the employment criteria was not breached at any time during that three-year period). However, if the amount repayable in the event of breaching the employment condition reduces with the passage of time (eg evenly over the three-year period), then the entity would recognise the grant in profit or loss as the grant becomes non-repayable (eg evenly over the three-year period).

Ex 24 **The facts are the same as in example 23. However, in this example, assume that the grant is conditional upon the plant remaining in commercial production for a period of five years from the date on which it was first brought into use.**

The entity undertook commercial production at the plant for six years before selling the plant to an independent third party on 1 April 20Y4.

The CU500,000 government grant received must be recognised as a liability on 1 January 20X7 (debit cash and credit liability).

On 31 March 20Y3 the entity satisfies all the performance conditions—the plant was used in commercial production for a period of five years (from 31 March 20X8 to 31 March 20Y3). Accordingly, on 31 March 20Y3 the CU500,000 government grant must be recognised in income and the liability must be derecognised.

On 1 April 20Y4 the entity accounts for the sale of the plant (see Section 17 *Property, Plant and Equipment*).

Ex 25 **Facts are the same as in example 23. However, in this example, assume that the entity becomes unconditionally entitled to CU100,000 of the grant at the end of each of the first five years of commercial operation of the plant.**

The entity undertook commercial production at the plant for six years before selling the plant to an independent third party.

The CU500,000 government grant received must be recognised as a liability on 1 January 20X7 (see paragraph 24.4(c)). The entity satisfied the performance condition in order to receive CU100,000 of the grant on each of the first five 12-month anniversaries of the start of commercial production at the plant. Accordingly, on 31 March 20X9, and on 31 March for each of the next four years, the entity must derecognise CU100,000 of the liability and recognise it in income (see paragraph 24.4(b)).

Ex 26 **On 1 January 20X7 a local government granted the entity, free of charge, a licence to broadcast in a particular city for a ten-year period. The terms of the grant of the licence require the entity to broadcast specific types of programmes for at least 20 hours a day throughout the licence period. Furthermore, if the entity does not meet this performance condition, the licence will be revoked immediately.**

For simplicity, assume there are 365 days a year in each of the 10 years.

On 1 January 20X7 the entity must recognise the fair value of the licence as a government grant as a liability and the licence (see paragraph 24.5) as an asset (see paragraph 24.4(c)). For each day the entity satisfies the performance conditions—broadcasting the specific types of programmes for at least 20 hours that day—1/3,650 of the of the liability recognised for the grant must be derecognised and recognised in income (see paragraph 24.4(b)).

24.5 An entity shall measure grants at the fair value of the asset received or receivable.

Examples – measurement

Ex 27 **During 20X7 the entity received from a national government, free of charge, a transferable licence to catch 100 tonnes of fish per year for each of the next five**

years, in that jurisdiction's waters. If the entity catches more than 100 tonnes of fish in a particular year, the five--year licence will not be revoked. However, the entity will be required to pay a severe fine.

On the basis of quoted prices for similar fishing quotas, the fair value of the fishing licence received is CU400,000.

During 20X7 when the fishing licence is first recognised the entity (ie debit intangible asset and credit income), it must measure the grant at CU400,000.

Ex 28 **The facts are the same as in example 27. However, in this example, the grant of the licence is conditional upon the entity obtaining certification as meeting certain environmental conditions before commencing fishing. Certification requires the entity to replace all nets with dolphin friendly fishing nets to, ensure that boat engines meet strict safety requirements etc. The licence was conditionally awarded to the entity on 1 January 20X7.**

On 2 February 20X7 the entity was certified as in compliance with the environmental conditions.

The fair value of the licence received is CU380,000.

On 2 February 20X7 when the entity was certified compliant with the environmental conditions for the licence the entity must recognise CU380,000 in income.

Ex 29 **On 1 January 20X1 a local government issued three identical licences to broadcast in a particular city for a ten-year period. Two licences were sold by public auction to independent third parties from outside the local community for CU100,000 each. To encourage local ownership, the third licence was granted to a local entity free of charge. The licences are unconditionally transferable.**

The local entity that received the third broadcasting licence must measure income (from the government grant) at fair value on initial recognition, which after consideration of all evidence available is determined to be the price paid by the independent third parties of CU100,000.

The licence is an intangible asset that should be recognised in the financial statements in accordance with Section 18 *Intangible Assets*.

Ex 30 **In 20X7 an entity provided catering and cleaning services under a contract with the local government that amounted to 30 per cent of its annual revenue.**
The government use the services of this particular entity on the condition that at least one-third of the entity's workforce comprises adults with physical disabilities. The government pays for the services at an hourly rate that is 50 per cent above the rate charged to other customers of the entity. The total amount received from the government in 20X7 is CU150,000.

The excess paid by the government over the normal market rate (ie CU50,000) is a government grant. It is a transfer of resources to the entity in return for compliance with conditions relating to the employment of disabled employees.

Only the additional 50 per cent paid over the market rate is a government grant. In accordance with Section 22 *Revenue* the rest of the amount paid by the government (ie CU100,000) is treated as revenue arising from the rendering of services.

Ex 31 **To encourage entities to expand their operations in a specified development zone, where it is difficult for entities to obtain financing for their projects, the government provides interest-free loans to fund the purchase of manufacturing equipment.**

In accordance with the development scheme, an entity receives an interest-free loan from the government for CU500 for a period of three years. The market rate of interest for similar loans is 5 per cent per year (ie the market rate of interest for a similar three-year loan to the entity).

There are no future performance conditions attached to the interest-free loan.

The present value of the loan (financial liability) is CU500/$(1.05)^3$ = CU431.92.

The difference between the CU500 and the CU431.92 of CU68.08 is a government grant and is recognised immediately as there are no specified future performance conditions.

In accordance with Section 11 *Basic Financial Instruments* the entity measures the loan on initial recognition at CU431.92. This amount will accrete to CU500 over the three-year term using the effective interest method.

The journal entry on initial recognition is:

Dr	Financial asset—cash	CU500	
	Cr Financial liability—loan		CU431.92
	Cr Income—profit or loss		CU68.08

Ex 32 **The facts are the same as example 31. However, in this example, instead of the loan being interest-free the government charges 2 per cent per year interest on the loan (ie CU10 per year).**

The present value of the loan (financial liability) is CU459.15. The present value is calculated using the market rate of 5 per cent as follows:

Time	*Cash payable A*	*Discount factor (5%) B*	*Present value A x B*
Year 1	10	0.9524	9.52
Year 2	10	0.9070	9.07
Year 3	10	0.8638	8.64
Year 3	500	0.8638	431.92
		Total	**459.15**

The difference between the CU500 and the CU459.15 of CU40.85 is a government grant and is recognised immediately, as there are no specified future performance conditions.

In accordance with Section 11 *Basic Financial Instruments* the entity measures the loan on initial recognition at CU459.15. This amount will accrete to CU500 over the three-year term using the effective interest method.

The journal entry on initial recognition is:

Dr	Financial asset—cash	CU500	
	Cr Financial liability—loan		CU459.15
	Cr Income—profit or loss		CU40.85

Disclosures

24.6 An entity shall disclose the following about government grants:

(a) the nature and amounts of government grants recognised in the financial statements.

(b) unfulfilled conditions and other contingencies attaching to government grants that have not been recognised in income.

(c) an indication of other forms of government assistance from which the entity has directly benefited.

Example – disclosures

Ex 33 **A group could make the following discloses about government grants:** *Reference to* IFRS for SMEs

XYZ Group

[Extract from] Consolidated statement of financial position

	Note	**at 31 December 20X2** CU	**at 31 December 20X1** CU	
…				
Current liabilities				
Government grant	15	40,000	60,000	24.6(a)
…				

XYZ Group

[Extract from] Consolidated statement of comprehensive income

	Note	**for the year ended 31 December 20X2** CU	**for the year ended 31 December 20X1** CU	
…				
Profit before tax	28	180,000	130,000	24.6(a)
…				

XYZ Group

[Extract from] Notes

Note 2 Accounting policies

Government grants

Government grants are recognised at the fair value of the asset received or receivable. A grant without specified future performance conditions is recognised in income when the grant proceeds are receivable. A grant that imposes specified future performance conditions is recognised in income when those conditions are met.

Government grants are presented separately from the assets to which they relate. Government grants recognised in income are presented separately in the notes. Government grants received before the income recognition criteria are satisfied are presented as a separate liability in the statement of financial position.

No amount is recognised for those forms of government assistance that cannot reasonable have a value placed on them. However, the entity discloses information about such assistance.

Note 15 Government grants and other forms of government assistance

In 20X0 the entity received CU100,000 from a local government as an incentive to operate a local-language film making studio.
The incentive is conditional on the entity producing at least one local-language film in each of the next five-years. If in any of the five years of the grant, the entity does not produce a local-language film it is required to refund to the local government one-fifth of the CU100,000 grant for each year that a film is not produced. 24.6(a) & (b)

In 20X2 management of the entity attended the Cannes film festival to promote the entity's latest local-language film. In order to promote overseas interest in the film, the entities local government provided free support to the management which involved helping the entity to promote its film to the attendees. No amount was recognised for this government assistance, as this form of assistance cannot reasonably have a value placed on it. 24.6(c)

XYZ Group

[Extract from] Notes

Note 28 Profit before tax

The following items have been recognised as expenses (income) in determining profit before tax:

	for the year ended 31 December 20X2	for the year ended 31 December 20X1	
	CU	CU	
Government grant for producing local-language films	(20,000)	(20,000)	24.6(a)
Government grant for agricultural activities	(15,000)	(15,000)	24.6(a)

…

Government grants of CU15,000 (20X1: CU15,000) have been received in the current period for not cultivating 40 acres of land during the year. 24.6(a)

24.7 For the purpose of the disclosure required by paragraph 24.6(c), government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under specified criteria. Examples include free technical or marketing advice, the provision of guarantees, and loans at nil or low interest rates.

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs* to transactions and events often requires judgement. Information about significant judgements and key sources of estimation uncertainty is useful in assessing an entity's financial position, performance and cash flows of.

Consequently, in accordance with paragraph 8.6, an entity must disclose the judgements that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Furthermore, in accordance with paragraph 8.7, an entity must disclose information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Other sections of the *IFRS for SMEs* require disclosure of information about particular judgements and estimation uncertainties.

Measurement

An entity that applies the *IFRS for SMEs* model of accounting for government grants must measure government grants at the fair value of the asset received or receivable. In many cases the entity will receive cash or a refund of expenses and hence little difficulty will be encountered in determining the fair value. However, significant judgement in measuring the fair value of a government grant may need to be applied in certain circumstances (eg if a non-cash asset or service received by way of government grant is not traded in an active market and there have been no recent arm's length exchange transactions between willing buyers and willing sellers, involving similar assets or services).

Module 24 – Government Grants

COMPARISON WITH FULL IFRSs

The following are the main differences between the requirements as issued at 9 July 2009 for accounting for government grants in accordance with full IFRSs (see IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* and paragraphs 34–38 and 57 of IAS 41 *Agriculture*) and the *IFRS for Small and Medium-sized Entities* (see Section 24 *Government Grants*):

- The *IFRS for SMEs* is drafted in simple language with less application guidance than is provided in full IFRSs.
- In the *IFRS for SMEs*, Section 24 applies to all government grants. In full IFRSs, IAS 41 specifies requirements for government grants that are related to a biological asset measured at fair value less costs to sell and IAS 20 applies to all other government grants.
- For a government grant that is related to a biological asset measured at its fair value less costs to sell, the requirements under the *IFRS for SMEs* are consistent with the requirements of IAS 41.
- For other government grants (ie those within the scope of IAS 20) there are differences in the recognition and measurement requirements between full IFRSs and the *IFRS for SMEs*.
  - IAS 20 contains numerous options for accounting for government grants. The *IFRS for SMEs* contains only one option for accounting for all government grants.
  - IAS 20 requires that government grants should not be recognised *until there is reasonable assurance* that the entity will comply with the conditions attaching to them and the grants will be received. Under Section 24, a government grant is not recognised until the conditions are actually satisfied.
  - IAS 20 requires government grants to be recognised as income over the periods necessary to match them with the related costs for which they are intended to compensate, on a systematic basis. Section 24 does not allow an entity to match the grant with the expenses for which it is intended to compensate or the cost of the asset that it is used to finance.
  - Under IAS 20, an entity that receives a non-monetary grant is permitted to measure both the asset and the grant either at a nominal amount (often zero) or at the fair value of the non-monetary asset. Under Section 24 all government grants, including non-monetary government grants, must be measured at the fair value of the asset received or receivable. Section 24 does not contain any requirements for the measurement and recognition of the related asset and hence that asset should be accounted for under the applicable section of the *IFRS for SMEs* (eg intangible assets received by way of government grant are accounted for under Section 18 *Intangible Assets other than Goodwill*).
- For other government grants (ie those within the scope of IAS 20) there are differences in the presentation requirements between full IFRSs and the *IFRS for SMEs*.
  - IAS 20 has specific requirements for the presentation of government grants. IAS 20 permits two methods for the presentation of government grants related to assets in the statement of financial position—either setting up a government grant as deferred income or deducting the government grant in arriving at the carrying amount of the related asset. IAS 20 also permits two methods for the presentation of government grants related to income in the statement of comprehensive income—either separately (or under a general heading such as ‘other income’) or deducted in reporting the related expense.

Module 24 – Government Grants

The *IFRS for SMEs* does not specify any methods for the presentation of government grants. However deducting a government grant in arriving at the carrying amount of the related asset in the statement of financial position (one of the options under IAS 20) would not be consistent with the requirements in other sections of the *IFRS for SMEs* for accounting for those assets. In any case, the *IFRS for SMEs* requires disclosure of how government grants are presented in financial statements.

Module 24 – Government Grants

TEST YOUR KNOWLEDGE

Test your knowledge of the requirements for accounting and reporting of government grants and other forms of government assistance in accordance with the *IFRS for SMEs* by answering the questions below.

Once you have completed the test check your answers against those set out below this test.

Assume all amounts are material.

Mark the box next to the most correct statement.

Question 1

A government grant is:

☐ (a) assistance from the government in the form of a transfer of resources to an entity in return for past or future compliance with specified conditions relating to the operating activities of the entity.

☐ (b) unconditional assistance from the government in the form of a transfer of resources to an entity.

☐ (c) any type of assistance from the government to the entity from which the entity has benefited directly.

Question 2

Government grants exclude which of the following forms of government assistance?

☐ (a) those forms of government assistance that cannot reasonably have a value placed upon them.

☐ (b) transactions with government that cannot be distinguished from the normal trading transactions of the entity.

☐ (c) both (a) and (b).

☐ (d) neither (a) nor (b).

Question 3

An entity shall measure all government grants:

☐ (a) at the amount of cash or cash equivalents received.

☐ (b) at the amount of cash or cash equivalents received or receivable.

☐ (c) at the fair value of the asset received or receivable.

☐ (d) any of the above.

Question 4

An entity must recognise a government grant that does not impose specified future performance conditions on that entity (the recipient):

- ☐ (a) in income when the grant proceeds are receivable.
- ☐ (b) in income over the periods necessary to match it with the related costs for which it is intended to compensate, on a systematic basis.
- ☐ (c) by applying either (a) or (b) above depending upon the accounting policy adopted by the entity.
- ☐ (d) none of the above.

Question 5

An entity must recognise a government grant that imposes specified future performance conditions upon that entity:

- ☐ (a) in income when the grant proceeds are receivable.
- ☐ (b) in income over the periods necessary to match it with the related costs for which it is intended to compensate, on a systematic basis.
- ☐ (c) in income only when the performance conditions are met.
- ☐ (d) none of the above.

Question 6

An entity must recognise government grants received before the income recognition criteria are satisfied:

- ☐ (a) in income when the grant proceeds are received.
- ☐ (b) in equity—deferred income.
- ☐ (c) as a liability.
- ☐ (d) none of the above.

Question 7

On 1 January 20X1 an entity acquired a transferable nine-year taxi licence by way of government grant when the fair value of the licence was CU90,000. The licence is given, free of charge, to the entity on the basis of the entity's performance and there are no future performance conditions attached to the grant.

The entity shall account for the government grant as follows:

- ☐ (a) recognise CU90,000 in income on 1 January 20X1.
- ☐ (b) recognise CU90,000 in income evenly over the nine-year period of the licence, ie CU10,000 per year.
- ☐ (c) credit CU90,000 directly to retained earnings on 1 January 20X1.

Question 8

On 1 January 20X1 an entity acquired, free of charge, a non-transferable nine-year taxi licence by way of government grant when the fair value of the taxi licence was CU90,000. In accordance with the terms of the licence the entity must operate at least 10 taxis in a deprived neighbourhood of the capital city during that nine-year period. Failure to do so will result in the taxi licence being revoked immediately.

The entity shall account for the government grant as follows:

☐ (a) recognise CU90,000 in income on 1 January 20X1.

☐ (b) recognise CU90,000 in income evenly over the nine-year period of the licence (ie CU10,000 per year when the performance condition of the government grant is met).

☐ (c) credit CU90,000 directly to retained earnings on 1 January 20X1.

☐ (d) recognise CU90,000 in income on 31 December 20X9.

Question 9

On 1 January 20X1 an entity acquired, free of charge, a herd of 100 cattle by way of government grant when the fair value of the herd was CU1,000,000. On average the remaining life of the cattle is expected to be 10 years. The grant does not impose future performance conditions on the entity.

The entity shall account for the government grant as follows:

☐ (a) recognise CU1,000,000 in income on 1 January 20X1.

☐ (b) recognise CU1,000,000 in income evenly over the 10-year expected remaining life of the cattle (ie CU100,000 per year).

☐ (c) credit CU1,000,000 directly to retained earnings on 1 January 20X1.

☐ (d) none of the above.

Question 10

In 20X1 the management of a private entity attended one of the world's biggest trade fairs for that entity's industry to promote and demonstrate its latest products. In order to promote overseas trade for that particular industry, the national government provided free support to the management which involved helping them to design it's display, secure a space at the event and make travel and logistical arrangements. The government also provided free advice on what the management should say to those attending the fair and the type of promotional literature it should give them. The government assistance cannot reasonably have a value placed on it.

The entity must:

☐ (a) determine the fair value of the government assistance and recognise income equal to that fair value for the year ended 31 December 20X1.

☐ (b) disclose the fact that the entity has benefited directly from marketing support from the national government at the trade fair (ie indicate the nature of government assistance received in its 20X1 financial statements).

☐ (c) neither recognise nor disclose the government assistance received during the year.

☐ (d) recognise in equity the fair value of the assistance received directly during 20X1.

Module 24 – Government Grants

Answers

Q1 (a) see paragraph 24.1
Q2 (c) see paragraph 24.2
Q3 (c) see paragraph 24.5
Q4 (a) see paragraph 24.4(a)
Q5 (c) see paragraph 24.4(b)
Q6 (c) see paragraph 24.4(c)
Q7 (a) see paragraph 24.4(a) and 24.5
Q8 (b) see paragraph 24.4(b) and 24.5
Q9 (a) see paragraph 24.4(a) and 24.5
Q10 (b) see paragraph 24.2 and 24.6(c)

Module 24 – Government Grants

APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements accounting and reporting government grants and other forms of government assistance in accordance with the *IFRS for SMEs* by solving the case studies below.

Once you have completed the case study check your answers against those set out below this test.

Case study 1

On 1 January 20X7 SME A received a CU1,000,000 grant from national government as an incentive to establish and operate a manufacturing plant in a particular location—the development zone. Funds are remitted from the government to SME A when SME A incurs the expenditure.

CU600,000 of the grant is conditional on SME A erecting plant costing at least CU2,000,000 in the development zone and the plant commencing commercial production on or before 31 December 20X8. Certain conditions are attached to the type of expenditure making up the CU2,000,000. If these conditions are not met, SME A will be obliged to refund the CU600,000 to the national government.

CU400,000 of the grant is conditional upon SME A maintaining commercial production at the plant for a period of four years from the date when commercial production begins. SME A will become unconditionally entitled to CU100,000 at the end of each of the first four years of the commercial operation of the plant.

During 20X7 SME A constructed the plant at a cost of CU2,100,000, all of which met the type of expenditure specified under the conditions of the grant.

During the first quarter of 20X8 SME A tested the plant's manufacturing process.

On 1 April 20X8 SME A began commercial production at the plant.

SME A assessed the useful life of the plant as 20 years from 1 April 20X8 with a nil residual value. Furthermore, the straight-line method is assessed as the most appropriate basis for depreciating the plant.

At 31 December 20X8 and 31 December 20X9 SME A's assessment of the plant remained unchanged.

Since the start of production, the plant has operated profitably. Furthermore, SME A intends to continue operating the plant on a commercial basis for the foreseeable future.

Prepare accounting entries to record the information set out above in the accounting records of SME A for the years ended 31 December 20X7, 20X8 and 20X9.

Module 24 – Government Grants

Answer to case study 1

During 20X7

Dr	Cash	CU1,000,000	
	Cr Liability		CU1,000,000

To recognise as a liability the government grant received before the income recognition criteria are satisfied.

Dr	Property, plant and equipment—cost	CU2,100,000	
	Cr Cash		CU2,100,000

To recognise the cost of plant constructed.

1 April 20X8

Dr	Liability	CU600,000	
	Cr Profit or loss—other income, government grant		CU600,000

To recognise as income the part of the government grant for which the performance conditions are satisfied (ie plant costing in excess of CU2,000,000 of qualifying expenditure was constructed and brought into use in the development zone).

During 20X8

Dr	Profit or loss—depreciation (operating expenses)	CU78,750[(a)]	
	Cr Property, plant and equipment—accumulated depreciation		CU78,750

To recognise depreciation expense for the nine-month period ended 31 December 20X8.

1 April 20X9

Dr	Liability	CU100,000	
	Cr Profit or loss—other income, government grant		CU100,000

To recognise as income the part of the government grant for which the performance conditions are satisfied (ie the plant was operated commercially for 12 months).

During 20X9

Dr	Profit or loss—depreciation (operating expenses)	CU105,000[(a)]	
	Cr Property, plant and equipment—accumulated depreciation		CU105,000

To recognise depreciation expense for the 12-month period ended 31 December 20X9.

The calculations and explanatory notes below do not form part of the answer to this case study:

(a) CU105,000[(b)] depreciation for a year x 9/12 months (ie April to December) = CU78,750 depreciation for 9 months.

(b) CU2,100,000 depreciable amount ÷ 20-year useful life = CU105,000 depreciation per year.

Case study 2

On 1 January 20X7 SME B received CU1,000,000 from a national government as an incentive to establish and operate a manufacturing plant in a particular location—the development zone. Funds are remitted from the government to the SME B when SME B incurs the expenditure.

CU600,000 of the grant is conditional on the entity erecting plant costing at least CU2,000,000 in the development zone and the plant commencing commercial production on or before 31 December 20X8. If these conditions are not met, SME B will be obliged to refund CU600,000 to the national government.

CU400,000 of the grant is conditional upon SME B maintaining commercial production at the plant for a period of four years from the date on which commercial production begins, ie SME B will become unconditionally entitled to CU8,333.33 at the end of each month for the first 48 months of the commercial operation of the plant.

During 20X7 SME A constructed the plant at a cost of CU2,100,000, all of which met the type of expenditure specified under the conditions of the grant.

During the first quarter of 20X8 SME B tested the plant's manufacturing process.

On 1 April 20X8 SME B began commenced commercial production at the plant.

SME B assessed the useful life of the plant as 20 years from 1 April 20X8 with a nil residual value. Furthermore, the straight-line method was assessed as the most appropriate basis for depreciating the plant.

At 31 December 20X8 and 31 December 20X9 SME B's assessment of the plant remained unchanged.

Since the start commencement of production, the plant has operated profitably. Furthermore, SME B intends to continue operating the plant on a commercial basis for the foreseeable future.

During 20X8, in accordance with a national government's incentive scheme to increase the export of goods manufactured in that country, SME B received marketing support free of charge from the national government at trade fairs in Frankfurt, Johannesburg, London, New York and Tokyo.

Draft an extract showing how the government grants could be presented and disclosed in the consolidated financial statements of SME B for the year ended 31 December 20X9.

Answer to case study 2

SME B Group
[Extract from] consolidated statement of financial position
at 31 December 20X9

	Note	*20X9*		*20X8*	
Non-current liabilities					
Government grant	20	CU125,000	[a]	CU225,000	[b]
Current liabilities					
Government grant	20	CU100,000	[c]	CU100,000	[c]

[Extract from] Notes to SME B Group's financial statements for the year ended 31 December 20X9

Note 1 Basis of preparation and accounting policies

Government grants

Government grants are measured at the fair value of the asset received or receivable.

A grant without specified future performance conditions is recognised in income when the grant proceeds are receivable. A grant that imposes specified future performance conditions is recognised in income when those conditions are met

Government grants are presented separately from the assets to which they relate. Grants recognised in income are presented separately in the notes. Grants received before the income recognition criteria are satisfied are presented as a separate liability in the statement of financial position.

Note 5 Profit before tax

The following items have been recognised as expenses (income) in determining profit before tax:

	20X9		*20X8*	
	CU		*CU*	
Government grant received for the construction of new plant	-		(600,000)	
Government grant received for the operation of new plant	(100,000)	[d]	(75,000)	[e]

A grant of CU100,000 (20X7: CU75,000) from government X was recognised in income during 20X8. The grant is for operating a new plant on a commercial basis in jurisdiction Z.

This grant is in addition to the CU600,000 recognised in income in 20X7 for constructing the plant (see note 20).

Furthermore, to encourage export from jurisdiction Z, the entity received free promotional support from government X for exhibiting its products at various international trade fairs. No income or expense has been recognised in respect of this government assistance as the assistance cannot reasonably have a value placed on it.

Note 20 Government grant

On 1 January 20X7 a grant of CU1,000,000 was received from government X for constructing and operating a new plant in jurisdiction Z. The portion of the grant that related to the construction of the plant was recognised in income in 20X8 when the plant started commercial production. The CU400,000 balance of the grant is conditional on the new plant remaining in commercial production for a continuous period of four years. It is recognised in income as the entity becomes unconditionally entitled to it. At 31 December 20X9, 27 months of the grant period remain.

These calculations illustrate the workings only and would not be part of the actual disclosures in the financial statements.

(a) 48-month grant period less 21 months recognised to 31 December 20X9 = 27 months remaining. 27 months x CU8,333.33[f] = CU225,000 total. CU225,000 less CU100,000[c] current portion = CU125,000 non-current portion.

(b) 48-month grant period less 9 months recognised to 31 December 20X8 = 39 months remaining. 39 months x CU8,333.33[f] = CU325,000 total. CU325,000 less CU100,000[c] current portion = CU225,000 non-current portion.

(c) 12 months in the next year x CU8,333.33[f] = CU100,000.

(d) 12 months in commercial production in 20X9 x CU8,333.33[f] = CU100,000.

(e) 9 months in commercial production 20X8 x CU8,333.33[f] = CU75,000.

(f) CU400,000 ÷ 48 months = CU8,333.33 per month