Raymond Chabot Grant Thornton

IFRS Adviser Alert

COVID-19 – Accounting Considerations for CFOs: Government Grants

June 2020

Executive summary

The Grant Thornton International IFRS team has published *COVID-19 – Accounting Considerations for CFOs: Government Grants*.

Overview

As a response to the COVID-19 global pandemic, governments around the world are implementing measures to help businesses and economies get through it. The nature of government grants can take on various forms, such as below market rate loans, short-time working subsidies, relief funds, income-based tax credits, to name just a few.

While many forms of government assistance should be accounted for by applying IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, others should be addressed by other standards, such as IAS 12 *Income Taxes*. Entities will therefore need to assess the economic substance of any government assistance they are receiving to determine what is the appropriate accounting treatment.

The publication *COVID-19 – Accounting Considerations for CFOs: Government Grants* addresses four key questions to consider prior to determining the appropriate accounting treatment for government grants:

- Is the government assistance in the scope of IAS 20 or another standard?
- What is the correct recognition and measurement?
- Is it recognized in the correct period?
- How should the assistance received from governments be presented in the financial statements?

Resource

The publication *COVID-19 – Accounting Considerations for CFOs: Government Grants* follows this *IFRS Adviser Alert*.

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COVID-19 accounting considerations for CFOs

Government grants

As a response to the COVID-19 global pandemic, governments around the world are implementing measures to help businesses and economies get through it. The nature of government grants can take on various forms such as below market rate loans, short-time working subsidies, relief funds, income-based tax credits to name just a few.

While many forms of government assistance should be accounted for by applying IAS 20 'Accounting for Government Grants and Disclosure of Government Assistance' because they meet the following definition, others should be addressed by other standards such as IAS 12 'Income Taxes'.

Definition of a government grant
'Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.' (IAS 20.3)

Entities will therefore need to assess the economic substance of any government assistance they are receiving to determine what is the appropriate accounting treatment. Indicators to consider include:

- the amount of tax incentive is independent of taxable profit or tax liability
- the expenditure must be made on a particular activity or asset and other substantive conditions may be attached to the tax incentive relating to the operating activity of the entity.

In this article we discuss in more depth four key questions to consider prior to determining the appropriate accounting treatment:

- Is the government assistance in the scope of IAS 20 or another standard?
- What is the correct recognition and measurement?
- Is it recognised in the correct period?
- How should the assistance received from governments be presented in the financial statements?

Is the government assistance in the scope of IAS 20 or another standard?

In applying the definition of a government grant set out in IAS 20, entities need to consider what would be in the scope of the definition and what would be deemed to be other forms of assistance.

Potential examples of grants relating to the economic environment include:

- subsidised wages
- forgiveness of payroll-related liabilities, such as unpaid employee taxes withheld
- direct cash grants
- finance provided by government at below-market rates (IAS 20.10A)
- forgivable loans
- rent assistance.

The following stimulus measures may not be government grants:

- tax moratoriums and refunds
- income tax regulation changes.

To assist an entity's determination of whether a particular form of government assistance falls under IAS 20 or IAS 12, IAS 20 states that '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.' (IAS 20.2(b)).

For a transaction to be classified as a government grant, the grantor must be a government entity. Certain forms of government grants given to lessors for the benefit of lessees have been proposed, including land tax holidays or refunds, which may or may not be directed by a government body. Where a government body provides financial assistance (such as refunded land taxes) for the benefit of individual lessees (e.g. as rent abatement), one could reasonably conclude the grant as being received from the government and therefore it falls within the scope of IAS 20.

Contrast this with benefits that are directed to be used for lessees as a class, such as a lessor providing assistance, at its sole discretion, directly to lessees. Would that fall within the scope of IAS 20? Our view of this situation is that the benefits received were due to the relationship with the lessor rather than as a result of a government grant. In such an instance, lease modification accounting may apply unless the recently published practical expedient by the IASB is used.

Refer to our article on 'Accounting for Lease Modifications' which explains this practical expedient provided to lessees.

What is the correct recognition and measurement?

Entities that have not previously received a government grant may need to develop an accounting policy in relation to the assistance received and how it has been reflected in the entity's financial statements. In some instances, significant judgements from those charged with governance may be required to determine which accounting standard best reflects the economic substance of the assistance that has been received by the reporting entity.

Where government grants are received, typically the grant is recognised at the date at which it is reasonably assured that

a the entity will comply with the conditions attached; and
b the grants will be received. (IAS 20.7)

In many situations, the reporting entity will not need to wait for formal confirmation from the government agency providing the grant before recognising the economic assistance provided.

The way in which a grant is received does not impact the accounting of the grant, (for example, if it is received in cash or by reducing a liability to the government). In addition, the way it is accounted for should be consistent with how the expenses or the costs for which the grant are intended to compensate are recognised. Therefore, it is essential to determine the nature and the main objective of the COVID-19 assistance that has been provided by the government rather that its legal form.

Generally, the fair value of the consideration is directly observable – for instance, cash received. For other forms of subsidies, the determination of the fair value of the benefit granted may need to be computed using observable inputs. For finance provided at below-market rates, the fair value of the government grant is determined by reference to the relative fair value of the debt when fair valued in the absence of the government grant.

Measurement of government grants depends on the nature of the grant and the entity's accounting policy. For example, grants relating to assets or grants relating to income. Refer below for presentation options.

Is it recognised in the correct period?

IAS 20.12 applies: '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.'

The income is recognised within profit or loss as the conditions are complied with – for example, for subsidised wages, this could be the period of service for wages. Care should be taken to align the assistance received with requirements of the government agency providing the economic assistance (ie cash received for wage subsidies should not be used against any other costs unless specifically permitted to do so). If the government grant comes in the form of subsidised construction costs, then financial support received may relate to the period of construction.

When accounting for loans issued by financial institutions to construction companies, with a credit guarantee for that loan being provided by the government, preparers of financial statements need to assess whether, without the guarantee, the loan might never have been granted due to the financial difficulties encountered by the entity or the level of uncertainties around its capacity to rapidly recover from the present situation. If this circumstance exists, one could argue the subsidy should be spread over the term of the loan as an interest adjustment. Alternatively, others may take the view that since the loan is aimed at compensating a shortfall of cash due to a significant decrease in the level of revenue, the subsidy is aimed at compensating another type of cost or expense and therefore it could justifiably be recognised in profit or loss immediately. Before making a final determination, a careful assessment and evaluation of all facts and circumstances should take place.

"In applying the definition of a government grant set out in IAS 20, entities need to consider what would be in the scope of the definition and what would be deemed to be other forms of assistance."

How should the assistance from governments be presented in the financial statements?

The presentation of government grants is dependent on whether it is a grant related to income or a grant related to assets. Whilst government grants are more commonly in the form of income, there is potential that entities could receive grants related to the purchase, acquisition or construction of assets.

Grants related to income

Grants related to income are required to be presented as a part of profit or loss, either separately or under a general heading such as 'Other income'. Alternatively, they are deducted in reporting the related expense (IAS 20.29).

Note that grants are **not** revenue and should not be presented as such, even though they may have resulted as a direct fall in revenues

Therefore there is a policy decision available to entities as to how the grant is presented on the face of the profit or loss.

Our preference is that the grants be presented separately on the profit or loss and not netted against the related expense if it has predictive value. Presenting the expenses without offsetting this way reflects the uniqueness of the COVID-19 pandemic and its impact on its financial performance during the reporting period.

Disclosure of the effect of the grant on any item of income or expense which is required to be separately disclosed is usually appropriate.

Grants related to assets

For grants related to assets, IAS 20.12 (as noted above), and the paragraphs following, allow for such a grant to either:

a reduce the carrying value of the asset being acquired; or

b be recognised as deferred income and systematically amortised over a period matching the useful life of the acquired asset.

While this may not be as common as grants related to income, we have seen additional funding allocations from some governments going towards the purchase of ventilators and other respiratory support equipment for hospitals dealing with the consequences of COVID-19.

The first provides simpler accounting, while the second clearly demonstrates the relative benefit received and historical cost of the acquired asset. Either presentation is appropriate, but approach b) is generally preferred.

The profit or loss impact is presented in a manner consistent with grants related to income.

Example: Government Grants

RetailCo was significantly adversely impacted by decreases in foot-traffic and closed its stores on 15 March 2020. Economic and regulatory circumstances changed on 30 June 2020 such that RetailCo wished to reopen its stores, however the significant period of time with no cash inflow resulted in insufficient working capital to meet its lease obligations.

RetailCo received a two-year interest free loan from the government of CU1,000 secured over the assets of RetailCo with repayment due in full at the end of the loan term. RetailCo has determined that in an arms-length transaction, a counterparty would demand an interest rate of 10% per annum as simple interest, payable in arrears.

The fair value of the debt is thus determined as the net present value of the debt:

NPV of cash flows:	CU1,000/1.10^2
(Excel formula:	*=NPV(10%,0,1000)*
	CU826.45
Fair value of grant:	CU173.55

The fair value of the grant is recognised either as income upon receipt of the grant or over the term of the loan, whichever is appropriate.

How Grant Thornton can help

Preparers of financial statements will need to be agile and responsive as the situation unfolds. Having access to experts, insights and accurate information as quickly as possible is critical – but your resources may be stretched at this time. We can support you as you navigate through accounting for the impacts of COVID-19 on your business.

Now more than ever the need for businesses, their auditors and any other accounting advisors to work closely together is essential. If you would like to discuss any of the points raised, please speak to your usual Grant Thornton contact or visit **www.grantthornton.global/locations** to find your local member firm.

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