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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **February 2006, London**

Project: **Government Grants (Agenda Paper 4)**

INTRODUCTION

1. In February 2004, the Board decided to amend IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance.* Specifically, the Board decided to replace the recognition requirements of IAS 20 with those contained in IAS 41 *Agriculture* that apply to government grants related to biological assets measured at fair value less estimated point-of-sale costs and grants that require entities not to engage in specified agricultural activity. In other words**,** the Board decided that the more recent IAS 41 government grant model could be applied consistently to all government grants.

2. The Board decided that the scope of the project should be limited. It would just delete parts of the existing IAS 20 and replace them with appropriate paragraphs from IAS 41. It would not, for example, start reconsidering the definition of a government grant and how a grant should be distinguished from an exchange transaction with the government. The Board acknowledged that the resulting Standard would be a temporary solution and that at some point it would need to consider the topic of non-reciprocal transfers from first principles.

3. With no staff resources specifically dedicated to the project, momentum to see through the initial objective was lost. But the Board discussed an early draft of the revised

IAS 20 in July 2004 and concluded that the limited recognition requirements in IAS 41 would need to be expanded. In particular, the Board decided that it would need to clarify the distinction between a conditional and an unconditional government grant, because conditionality determines recognition in IAS 41.

4. Since July 2004 the staff has done further work on the project, however there have been no Board discussions. We have also noted that whenever the project is discussed in other contexts, some Board members express reservations about the direction of the project. Because of this, and also because of the passage of time, we think it is important for the Board to review (a) its decision to undertake this project at the present time and (b) the original scope of the project.

5. This paper will look to:

   (a) detail the initial reasons for deciding to complete a project to amend IAS 20 and highlight the reasons for using the IAS 41 model to achieve this;

   (b) detail the staff's concerns regarding the IAS 41 model and the scope of the current project;

   (c) provide a number of options for progressing with the project; and

   (d) provide a staff recommendation.

PART A: BACKGROUND TO DECISION TO AMEND IAS 20

Adding IAS 20 to the Agenda

6. The Board decided in 2004 to undertake a project to amend IAS 20 for the following reasons.

   (a) IAS 20 became effective in 1984. It can result in accounting that is inconsistent with the *Framework*. This is because IAS 20 matches the income from a grant with the expense it is intended to compensate. This can result in the recognition of a deferred credit when there is no present obligation, and thus no liability.

   (b) IAS 20 has a number of options creating inconsistency in accounting treatment. For example, an entity has the ability to deduct a grant from the carrying amount of the asset purchased in relation to that grant. Another option is to recognise at nil or nominal amounts non-monetary grants received. These options create inconsistent accounting between entities decreasing the comparability of financial statements and can result in an understatement of resources controlled by the entity.

(c) Leaving IAS 20 as it currently stands would require some jurisdictions (eg Australia and New Zealand) on first adopting IFRSs to apply accounting that is less consistent with the *Framework* compared to what they are currently doing. The Board did not wish to impose accounting standards that were less consistent with the *Framework* than the accounting they previously used, because this would be seen as a backward step for such jurisdictions.

(d) IAS 20 is inconsistent with more recent pronouncements from other national standard setting bodies that themselves are more consistent with the current *Framework* - specifically SFAS 116 *Accounting for Contributions Received and Contributions Made* (SFAS 116) [1] and UIG Abstract 11 *Accounting for Contributions of, or Contributions for the Acquisition of Non-current Assets* (UIG 11). Further to this, the International Public Sector Accounting Standards Board have published Exposure Draft 29: *Revenue from Non-Exchange Transactions (Including Taxes and Transfers)* in January 2006[2].

(e) The IFRIC used IAS 20 to reach a consensus for its work on IFRIC 3 *Emission Rights*[3]. Currently, an agenda proposal has been accepted to undertake a Board project on Emission Rights. The acceptance of this proposal has created further momentum for the completion of amendments to IAS 20.

Using the IAS 41 Model

7. The Board decided to amend IAS 20 using the IAS 41 model for the following reasons:

(a) Development of a new model from first principles needed to wait until further progress had been made in the Revenue Recognition project. This was because the Board concluded that its thinking in the Revenue Recognition project would

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[1] US GAAP does not have a specific standard on accounting for government grants by business entities because SFAS 116 excludes government grants to business entities from its scope. However, SFAS 116 provides an accounting model for non-reciprocal transfers which the staff believes is relevant when examining accounting for government grants.

[2] [Deleted].

[3] The staff notes that this interpretation was subsequently withdrawn in June 2005.

be relevant in developing a new model for government grants (indeed, it was thought possible that non-reciprocal transfers might be in the scope of the project).

(b) The only options therefore available to the Board were to withdraw the Standard or adopt an existing model.

(c) The Board did not believe withdrawing the Standard was a viable option.

(d) The IAS 41 model is an available alternative government grant model.

(e) The IAS 41 model is considered superior to IAS 20 because it is more consistent with the *Framework* and other national standards. Using the IAS 41 model would mean all government grants would be treated consistently in IFRS. It would also eliminate most of the options in IAS 20 thereby enhancing consistency of accounting treatment.

8. [Deleted]

PART B: CONCERNS ABOUT USING THE IAS 41 MODEL

Re-examination of the Government Grants Project

9. The decision to undertake this project with its original scope was a compromise arising from a desire to do something quickly about IAS 20 but recognising that developing a new conceptual approach in 2004 would be inappropriate given ongoing work in other projects. Reviewing this decision now, staff has (and we believe constituents will also have) two concerns about introducing the IAS 41 model:

(a) it requires a two-step approach to updating IAS 20; and

(b) the appropriateness of the IAS 41 model.

Two-step approach

10. The Board needs to decide whether it is appropriate to extend the use of the IAS 41 model more generally in IAS 20. We can reason that using the IAS 41 model is only the first step in updating IAS 20 and government grants will be revisited more comprehensively in due course. Amending the standard today potentially precludes the

Board from amending IAS 20 again for many years. Agenda time is a scarce resource and there are other topics that have more significance for more entities (ie they rank higher on the agenda setting criteria). Therefore, the Board may not have the opportunity to come back and revisit the topic again. [Part of paragraph deleted]

11. [Deleted].

Appropriateness of the IAS 41 model

12. The government grant model in IAS 41 distinguishes between unconditional and conditional grants. An unconditional grant is recognised in profit or loss when the grant is receivable. A conditional grant is not recognised in profit or loss until the condition is satisfied.

13. IAS 41 therefore provides recognition guidance only about income. It is silent about the nature and treatment of assets and liabilities arising from a government grant. However, if an entity *receives* a conditional grant, the income recognition guidance means that the entity recognises an asset (typically cash) and a corresponding liability (because it cannot recognise income). The Basis for Conclusion suggests that the liability is for the obligation to satisfy the condition.

14. There are two points to note about this liability:

    (a) it is measured initially by reference to the amount recognised for the granted asset; and

    (b) it is not remeasured (it may be partly derecognised if the entity becomes unconditionally entitled to retain the grant over time).

15. Taken together, this means that recognition of the grant in profit or loss depends on the occurrence of a critical event, satisfaction of the condition. [Rest of paragraph deleted]

16. [Deleted].

17. [Deleted].

18. Consider for example an entity that receives a grant of CU1m on the condition that it refrains from farming its land for five years. If it does not satisfy the condition, the grant must be returned. [Rest of paragraph deleted]

19. Another example would be where a University is given a grant of CU5m which must be used to rent a certain lecture theatre for five years. To retain the grant the building must be used for the purpose of education at the University and the cost of maintenance must be born by the University. If the conditions are not met at any time during the next five years, the University must return the full amount of the grant. The University estimates the cost to use and maintain the building is CU100,000 a year. [Rest of paragraph deleted]

20. [Deleted]

21. [Deleted]

22. [Deleted]

23. [Deleted]

Conclusions

24. When considering in isolation the above discussion, the staff concludes that the IAS 41 model does not appear to be the best option going forward, both because of concerns about the suitability of the IAS 41 model and the creation of a two step approach. **Accordingly, we would recommend removing the IAS 20 project from the Board's agenda, deferring reconsideration until other related projects have progressed further**. There are, however, three important issues that must be considered before making this decision.

25. Firstly, to withdraw the project would send the wrong signal to national standard setting bodies in Australia and New Zealand. [Rest of paragraph deleted].

26. Secondly, the Board has placed the current project on the SEC roadmap as a short-term convergence project. [Rest of paragraph deleted] .

27. [Deleted].

28. [Deleted].

29. Thirdly the Board has recently accepted on to its agenda a project on Emission Trading Schemes. [Rest of paragraph deleted]

30. [Deleted].

31. A further option could be to remove *both* the IAS 20 project and the emission rights project from the Board's agenda. [Rest of paragraph deleted]

32. In summary, assuming for now that the Board believes the emission rights project needs to be completed, then the staff propose the following options with regard to the government grants project.

PART C: OPTIONS GOING FORWARD

33. The following options are available to the Board:

(a) proceed with original project plan – use the IAS 41 model to replace the recognition and measurement principles included in IAS 20:

(b) extend the project to create a new model for accounting for government grants using the amended to IAS 37 as guidance (once the IAS 37 project is completed);

(c) change the scope of the IAS 41 model so that it is applicable to any asset measured at fair value (not just biological assets);

(d) withdraw the project and leave IAS 20 in place until further work is completed on revenue recognition, resolving emission rights separately.

Below is an analysis of each of the advantages and disadvantages of the above options.

[Deleted paragraphs 34 – 41]

PART D: STAFF RECOMMENDATIONS

42. The staff recommends removing the IAS 20 project from the Board's agenda, deferring reconsideration until other related projects have progressed further.