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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**21 June 2007, London**
Project:	**Annual Improvements**
Subject:	**IAS 39 & IAS 20 – Accounting for nil or low interest loans received from a government (Agenda paper 12H)**

1. The staff have identified that the following issue would be most appropriately resolved via the annual improvements process.

   Issue: Should the apparent inconsistency between IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, and IAS 39, *Financial Instruments: Recognition and Measurement*, on the accounting for nil or low interest loans received from a government be removed?

Staff recommendation

2. The staff recommends that the Board:

   - should add this issue to the annual improvements project; and
   - should amend IAS 20 as proposed in paragraph 14 of this paper.

Background

3. The staff have been notified of an apparent inconsistency in the guidance in IAS 20 and IAS 39. It relates to the accounting for a nil or low interest loan received from a government. IAS 20 states that no interest should be imputed for such a loan, whereas IAS 39 requires that all loans are recognised at fair value, thus imputing interest to the loan.

IAS 20 guidance

4. Paragraph 37 of IAS 20 states that 'Loans at nil or low interest rates are a form of government assistance, but the benefit is not quantified by the imputation of interest'.

IAS 39 guidance

5. Paragraph 43 of IAS 39 requires that a financial liability is measured at fair value when recognised initially. The loan is subsequently measured at amortised cost in accordance with paragraph 47 of IAS 39. The difference between the fair value of a nil or low interest loan on recognition and the amount of cash received from the lender is the value of the benefit received from the reduced interest rate. That benefit (gain) is recognised in the income statement on an appropriate basis. IAS 20 provides guidance on the recognition of the benefit of a government grant.

6. Government grants and government assistance are not excluded from the scope of IAS 39. It appears therefore that the guidance in both standards applies to the accounting for nil or low interest government loans.

Analysis

7. Arguments can be made for applying either of the two standards. IAS 20 can be viewed as the more specific standard as it addresses a narrowly defined sub-set of nil or low interest loans and, accordingly, the IAS 20 guidance should be applied. The alternative view is that IAS 39 is a more recent standard and does not exclude government loans from its scope – to do so

would introduce inconsistency with the way other nil or low interest loans are accounted for.

8. The impact of applying IAS 39 to account for the loan would be to recognise the loan from the government at its fair value. The carrying amount of the loan would be accreted to its repayment value using the effective interest method. The effect of this on the entity's results is to record an interest expense in the income statement over the life of the loan.

9. The difference between the loan received from the government and its fair value on recognition represents the benefit received from the government. This amount would be recognised in the income statement over the periods in which the entity recognises as expenses the related costs that the benefit is intended to compensate, on a systematic basis [IAS20.12]. The benefit of grants related to assets is presented in the balance sheet either as a deferred income balance or by deducting the grant in arriving at the carrying amount of the asset [IAS20.24]. For example, an interest free loan provided on condition that the entity purchases an item of property, plant and equipment (PPE), would give rise to;
   i) an interest expense over the life of the loan calculated using the effective interest method; and
   ii) a reduced depreciation charge for the item of PPE on a straight line basis over the life of the asset.
   The interest expense and the reduced depreciation expense will be presented on a gross basis in their respective sections of the income statement.

10. The impact of applying IAS 20 without applying IAS 39 is that an interest free loan is recognised at its nominal amount and no interest expense is recorded over its life. The carrying amount of the loan is adjusted to reflect repayments to the government.

11. The staff believes that applying the accounting required by IAS 39, which requires the imputation of interest, provides more relevant information to a user of the financial statements than applying the guidance in IAS 20 without IAS 39.

Staff recommendation

12. The staff recommends that IAS 20 be amended as proposed in paragraph 14 to require the imputation of interest on nil or low interest government loans in accordance with IAS 39.

13. **Does the Board agree?**

Drafting

14. The staff recommend that IAS 20 should be amended as follows:

Government grants

…

10 A forgivable loan from government is treated as a government grant when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan.

10A A government loan at nil or low interest rates is treated as a government grant. The benefit of such a loan shall be quantified by the imputation of interest in accordance with IAS 39. The entity shall consider the conditions and obligations that have been, or must be, met when identifying the costs for which the benefit of the loan is intended to compensate. The benefit of a nil or low interest loan that is granted in relation to an asset shall be presented as described in paragraph 24. The loan shall be recognised and measured in accordance with IAS 39.

…

Government assistance

...

37 [deleted] ~~Loans at nil or low interest rates are a form of government assistance, but the benefit is not quantified by the imputation of interest~~.

...

Basis for Conclusions on
Proposed Amendments to IAS 20 Accounting for Government Grants and Disclosure of Government Assistance

This Basis for Conclusions accompanies, but is not part of, the draft amendments.

Accounting for nil or low interest loans from government

BC1 The Board has identified an apparent inconsistency in the guidance in IAS 20 and IAS 39. It relates to the accounting for a nil or low interest loan received from a government. IAS 20 states that no interest should be imputed for such a loan, whereas IAS 39 requires that all nil or low interest loans are recognised at fair value, thus imputing interest to the loan.

BC2 The Board has decided to address this inconsistency by requiring nil or low interest government loans to be recognised and measured in accordance with IAS 39. The benefit of the government loan is calculated by the imputation of interest in accordance with IAS 39. This benefit is accounted for in accordance with IAS 20.

Appendix – Extracts from IAS 20 – for information

Government grants

7 Government grants, including non-monetary grants at fair value, shall not be recognised until there is reasonable assurance that:

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

(b) the grants will be received.

8 A government grant is not recognised until there is reasonable assurance that the entity will comply with the conditions attaching to it, and that the grant will be received. Receipt of a grant does not of itself provide conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.

9 The manner in which a grant is received does not affect the accounting method to be adopted in regard to the grant. Thus a grant is accounted for in the same manner whether it is received in cash or as a reduction of a liability to the government.

10 A forgivable loan from government is treated as a government grant when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan.

11 Once a government grant is recognised, any related contingent liability or contingent asset is treated in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

…

Government assistance

34 Excluded from the definition of government grants in paragraph 3 are certain 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.

35 Examples of assistance that cannot reasonably have a value placed upon them are free technical or marketing advice and the provision of guarantees. An example of assistance that cannot be distinguished from the normal trading transactions of the entity is a government procurement policy that is responsible for a portion of the entity's sales. The existence of the benefit might be unquestioned but any attempt to segregate the trading activities from government assistance could well be arbitrary.

36 The significance of the benefit in the above examples may be such that disclosure of the nature, extent and duration of the assistance is necessary in order that the financial statements may not be misleading.

37 Loans at nil or low interest rates are a form of government assistance, but the benefit is not quantified by the imputation of interest.

38 In this Standard, government assistance does not include the provision of infrastructure by improvement to the general transport and communication network and the supply of improved facilities such as irrigation or water

reticulation which is available on an ongoing indeterminate basis for the benefit of an entire local community.

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