Conceptual Issues with IAS 20

IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* has been originally issued by the IASC in 1983 and has been subject to relatively few amendments since. It deals with all types of government assistance, excluding those related to income taxes, government participation in the ownership of the entity, and certain government grants covered by IAS 41 *Agriculture*. There is also an exception relating to financial statements or supplementary information reflecting the effects of changing prices – obviously an obsolete one as IAS 15 *Information Reflecting the Effects of Changing Prices* has been long withdrawn.

IAS 20 aims at matching the period in which the government grant income is recognised in profit or loss with the related costs for which the grant is intended to compensate. Grants receivable in compensation of past costs or for immediate financial support to the entity are recognised in profit or loss immediately.

The standard is written in a very different style from the newer standards; part of the wording is more suitable for a Basis for Conclusion than for a Standard. This makes the text of IAS 20 confusing, e.g. the discussion in para. 13-15 about income and capital approaches often makes readers think that a capital approach may also be acceptable under the Standard as well as the income approach. There are also issues of a conceptial nature with IAS 20, some of which are outlined below.

Inconsistency with the Conceptual Framework.

Recognition of a deferred credit which does not satisfy the definition of a liability. Application of IAS 20 can result in an entity recognising an amount in the statement of financial position as a deferred credit, for example:

- When an entity received an income-related grant but has not yet recognised it in profit or loss as the income needs to be matched with future related costs as required by para. 12,
- When an entity received an asset-related government grant and, as allowed by para. 26, recognises it as deferred income.

Such a deferred credit does not satisfy the definition of a liability in para. 4.4 (b) of the Conceptual Framework: “A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits”, as no outflow of resources is expected from the entity.

Different recognition requirements. Under para. 7 of IAS 20, for the government grants to be recognised, there needs to be reasonable assurance of the fulfilment of conditions of the grant and of the receipt of the grant. Government assistance which cannot be reasonably valued or which cannot be distinguished from normal trading activities of the entity is not recognised.

This differs from the requirements for recognition of the elements of financial statements in para. 4.38 of the Conceptual Framework, which refer to the probability of inflow or outflow of future economic benefits and to the possibility of reliable measurement of an item’s cost or value.

First, there is uncertainty about what constitutes a “condition”. Depending on how this is understood, IAS 20 may lead to recognition of a liability that does not meet the recognition requirements of the Conceptual Framework; this would happen e.g. if the entity not meeting a condition would not result in a probable outflow of economic benefits.

Similarly, IAS 20 does not elaborate on the meaning of “reasonable assurance” or “reasonably valued”. This inconsistency in wording may also be considered a difference in recognition criteria with the Conceptual Framework.

Interaction with other Standards.

While the removal in 2008 of para. 37 and addition of para. 10A of IAS 20 resolved an apparent conflict between IAS 20 and IAS 39 relating to initial recognition of below-market rate government loans, there remain issues of subsequent accounting for such loans, such as changes in estimates of future cash flows, loan modification and derecognition, where clear guidance is currently lacking. In addition, treatment of forgivable loans under IAS 20 is not consistent with the requirements for derecognition of financial liabilities in IAS 39 (IFRS 9).

There is no guidance on the interaction between the requirements of IAS 20 applicable to below-market interest rate loans and IAS 23. While there’s no apparent conflict between the

two Standards, there are transactions that are covered by both of them, such as construction of a qualifying asset subject to a government grant, incl. financed by a below-market rate government loan.

In respect of the deferred credit on a government grant, it is not clear whether it needs to be taken into account when performing an impairment test under IAS 36.

Existence of two different approaches to government grants - under IAS 41 for biological assets measured at fair value less costs to sell, and under IAS 20 for others – is hardly warranted; a single model would improve understandability of the financial information.

For government compensation of regulated rates, a clear distinction to be made between the scope of IFRS 14 and the future standard on rate regulation, and IAS 20.

Excessive diversity

IAS 20 contains numerous options. For example, an entity that receives a grant to finance the acquisition of an item of property, plant or equipment is entitled to deduct the grant from the carrying amount of that item, and an entity that receives a non-monetary grant is permitted to measure the asset and the grant at a nominal amount rather than fair value. In addition to reducing the comparability of financial statements, these particular options in IAS 20 result in understatement of the assets controlled by the entity and do not provide the most relevant information to users of financial statements.

Inconsistency with more recent pronouncements of standard-setting bodies.

As well as being inconsistent with the Framework, the recognition requirements of IAS 20 are also inconsistent with more recent pronouncements of standard-setting bodies relating to either non-reciprocal transfers in general or, more specifically, government grants. For example:

- FASB Statement No. 116 Accounting for Contributions Received and Contributions Made (SFAS 116), whilst exempting government grants to business entities from its scope, provides an accounting model that can be applied to government grants and that is consistent with the Framework. It distinguishes between conditional and unconditional promises to give; the unconditional ones are recognised as revenues

when received, and conditional contributions received – when the conditions are substantially met.

- In Australia, UIG Abstract 11 Accounting for contributions of, or contributions for the acquisition of, non-current assets, whilst specifying a different treatment for contributions subject to conditions than SFAS 116, is also consistent with the Framework. Abstract 11 requires non-reciprocal contributions to be recognised as revenue and as an asset, at fair value, when the entity gains control of the contribution. A liability and expense is only recognised when a present obligation to repay a contribution arises.
- International Public Sector Accounting Standard 23 Revenue from Non-Exchange Transactions (Taxes and Transfers) is also based on principles that are consistent with the Framework.