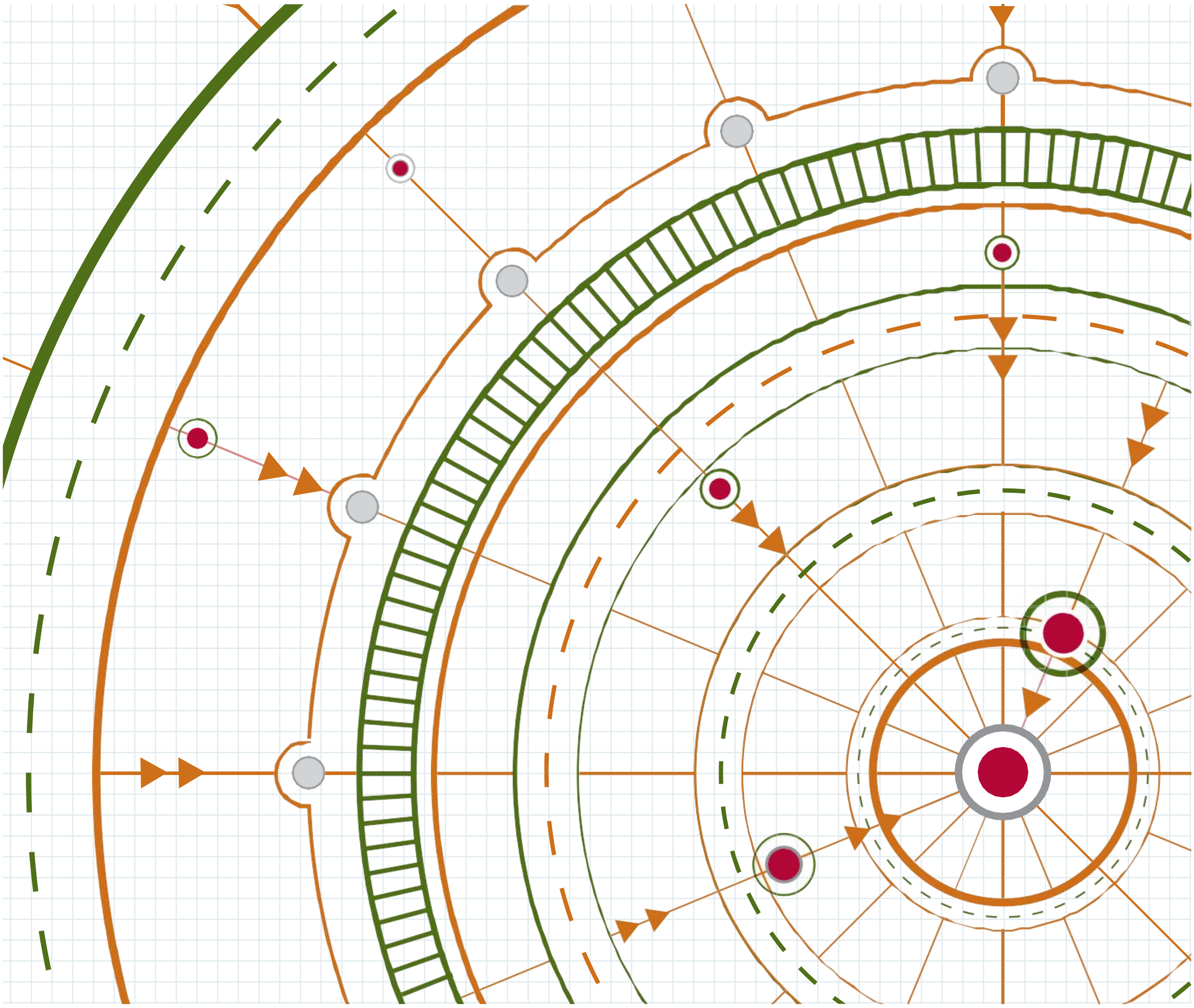
IFRS for SMEs® Standard (2015) + Q&As

IFRS® Foundation—Supporting Material for the *IFRS for SMEs* Standard

Module 24—Government Grants



IFRS®

IFRS® Foundation Supporting Material for the *IFRS for SMEs®* Standard

including the full text of
Section 24 *Government Grants*
of the *IFRS for SMEs* Standard
issued by the International Accounting Standards Board in October 2015

with extensive explanations, self-assessment questions and case studies

IFRS® Foundation
7 Westferry Circus
Columbus Building
Canary Wharf
London E14 4HD
United Kingdom

Telephone: +44 (0)20 7246 6410
Email: info@ifrs.org
Web: www.ifrs.org

Publications Department
Telephone: +44 (0)20 7332 2730
Email: publications@ifrs.org

This module has been prepared by IFRS Foundation (Foundation) education staff. It has not been approved by the International Accounting Standards Board (Board). The module is designed to assist users of the *IFRS for SMEs*® Standard (Standard) to implement and consistently apply the Standard.

Contents

Module 24 – Government Grants

The accounting requirements applicable to small and medium-sized entities (SMEs) presented in this training module are set out in the *IFRS for SMEs* Standard, issued by the International Accounting Standards Board (Board) in October 2015.

This module has been prepared by IFRS Foundation education staff.

The contents of Section 24 *Government Grants* of the *IFRS for SMEs* Standard are set out in this module and shaded grey. The Glossary of terms of the *IFRS for SMEs* Standard (Glossary) is also part of the requirements. Terms defined in the Glossary are reproduced in **bold type** the first time they appear in the text of Section 24. The notes and examples inserted by the education staff are not shaded. These notes and examples do not form part of the *IFRS for SMEs* Standard and have not been approved by the Board.

INTRODUCTION

Which version of the *IFRS for SMEs*® Standard?

When the *IFRS for SMEs* Standard was first issued in July 2009, the Board said it would undertake an initial comprehensive review of the Standard to assess entities' experience of the first two years of its application and to consider the need for any amendments. To this end, in June 2012, the Board issued a Request for Information: *Comprehensive Review of the IFRS for SMEs*. An Exposure Draft proposing amendments to the *IFRS for SMEs* Standard was subsequently published in 2013, and in May 2015 the Board issued *2015 Amendments to the International Financial Reporting Standards for Small and Medium-sized Entities (IFRS for SMEs* Standard*)*.

The document published in May 2015 only included amended text, but in October 2015, the Board issued a fully revised edition of the Standard, which incorporated additional minor editorial amendments as well as the substantive May 2015 revisions. This module is based on that version.

The *IFRS for SMEs* Standard issued in October 2015 is effective for annual periods beginning on or after 1 January 2017. Earlier application was permitted, but an entity that did so was required to disclose the fact.

Any reference in this module to the *IFRS for SMEs* Standard refers to the version issued in October 2015.

This module

This module focuses on the accounting for and reporting of government grants and other forms of government assistance applying Section 24 *Government Grants* of the *IFRS for SMEs* Standard. It introduces the subject and reproduces the official text along with explanatory notes and examples designed to enhance understanding of the requirements. The module identifies the significant judgements required in accounting for and reporting government grants and other forms of government assistance. In addition, the module includes questions designed to test your understanding of the requirements and case studies that provides an opportunity to apply the requirements for accounting for government grants and other forms of government assistance applying the *IFRS for SMEs* Standard.

Module 24—Government Grants

Upon successful completion of this module you should, within the context of the *IFRS for SMEs* Standard, be able to:

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

IFRS for SMEs Standard

The *IFRS for SMEs* Standard 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* Standard is comprised of mandatory requirements and other non-mandatory material.

The non-mandatory material includes:

- a preface, which provides a general introduction to the *IFRS for SMEs* Standard and explains its purpose, structure and authority;
- implementation guidance, which includes illustrative financial statements and a table of presentation and disclosure requirements;
- the Basis for Conclusions, which summarises the Board's main considerations in reaching its conclusions in the *IFRS for SMEs* Standard issued in 2009 and, separately, in the 2015 Amendments; and
- the dissenting opinion of a Board member who did not agree with the issue of the *IFRS for SMEs* Standard in 2009 and the dissenting opinion of a Board member who did not agree with the 2015 Amendments.

In the *IFRS for SMEs* Standard, Appendix A: Effective date and transition, and Appendix B: Glossary of terms, are part of the mandatory requirements.

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

The *IFRS for SMEs* Standard has been issued in two parts: Part A contains the preface, all the mandatory material and the appendices to Section 21, Section 22 and Section 23; and Part B contains the remainder of the material mentioned above.

Further, the SME Implementation Group (SMEIG), which assists the Board with supporting implementation of the *IFRS for SMEs* Standard, publishes implementation guidance as 'questions and answers' (Q&As). These Q&As provide non-mandatory, timely guidance on specific accounting questions raised with the SMEIG by entities implementing the *IFRS for SMEs* Standard and other interested parties. At the time of issue of this module (August 2018) the SMEIG has not issued any Q&As relevant to this module.

Module 24—Government Grants

Introduction to the requirements

The objective of general purpose financial statements of a small or medium-sized entity is to provide information about the entity's financial position, performance and cash flows 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. Such users include, for example, owners who are not involved in managing the business, existing and potential creditors and credit rating agencies.

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

An entity shall account for a government grant 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) a grant received before the income recognition criteria are satisfied is recognised as a liability.

An entity must measure government grants at the fair value of the asset received or receivable.

Section 24 also requires an entity to provide specified disclosures about its government grants and to indicate other forms of government assistance from which it has benefited directly.

What has changed since the 2009 *IFRS for SMEs* Standard

This section of the *IFRS for SMEs* Standard was mainly unchanged by the 2015 Amendments. However, this module may reproduce, but not highlight, minor changes or editorial corrections.

Module 24—Government Grants

REQUIREMENTS AND EXAMPLES

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 certain 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. Grants received from non-governmental development agencies or organisations—whether local, regional, national or international—may be accounted for by analogy similarly to government grants. The entity would need to consider the relevant facts and circumstances of the transaction or arrangement.

Government grants are sometimes called 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 attached to the grant. The purpose of the grant is often to encourage an entity to act in a way it would not normally act had the assistance not been provided.

If a government transfers resources to an entity in exchange for an equity interest in the entity, the transaction is not a government grant and should not be accounted for as such even if, as part of the transaction, the government imposes specific conditions relating to the operating activities of the entity. Similarly, a government loan to an entity does not constitute a grant in its own right. This is because an equity contribution or a repayable loan are normal business transactions and are therefore not in themselves 'assistance'. However, an entity would need to consider whether the arrangement in part constitutes assistance. Thus, the benefit of a government loan at no interest or at a below market rate of interest could be treated as a government grant if the other requirements are met. The benefit of a government loan at no interest or at a below market rate of interest is the difference between the present value of the loan discounted at its market rate and its nominal amount.

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 in certain regions or industry sectors. The conditions for receiving such assistance may not relate specifically 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 operate in underdeveloped areas or areas that lack basic amenities or infrastructure.

Such government assistance is a government grant. A general requirement to operate in particular regions or industry sectors to qualify for government assistance constitutes a condition as specified in paragraph 24.1. Therefore, the requirements of Section 24 regarding government grants shall 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 be used specifically for setting up farming operations in the specified area. Entities must submit a completed application, their proposal and specified documents, all of which the government will consider before issuing the grant.**

The upfront cash payment is assistance from a government in the form of a transfer of resources to the qualified entity. The requirement to set up farming operations in a specified rural area is a future condition related to the operating activities of the entity and is promised by the entity in return for the transfer of resources. Therefore, an entity receiving the upfront payment would conclude that it is a government grant. The entity will need to comply with the requirement regarding the establishment and operation of the farm 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 new type of technology that could lead to a significant improvement in healthcare. The local government agrees to reimburse Entity A 50% of specified project costs over a two-year period. In accordance with the agreement, Entity A must meet specified targets with regard to the performance of the technologies being developed. The entity must also prepare six-monthly progress reports for the government. If targets are met and progress is deemed satisfactory, the government is likely to provide further support in the future.**

The refund of a portion (50%) of the qualifying project costs by the government is assistance from government in the form of a transfer of resources to the entity. The requirement to meet specified targets with regard to the performance of the technologies being developed is a future condition related to the operating activities of the entity and is promised by the entity in return for the transfer of resources. Therefore, an entity would conclude that the refund is a government grant.

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 at a reasonable interest rate, the local government has offered 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 loan agreement specifies that the proceeds can only be used for those purposes.**

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

The interest-free element of the loan is a transfer of a resource from the government to Entity B since the entity does not need to pay interest at market rates and the government is forgoing interest income at market rates. The specified conditions that Entity B must comply with are that the loan proceeds must be used to fund the planned expansion of the business. Therefore, the interest element is a government grant. The capital amount of the loan (excluding the interest-free element) is not a government grant because, being a loan, the entity will be required to repay the government.

Ex 4 **On 31 December 20X7, an entity received CU40,000 from a national government for not cultivating 40 acres of its land during 20X7.**

The transfer of 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 5 **The facts are the same as in Example 4. 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 CU40,000 is a government grant—it is a resource transferred to the entity from a government-like body in return for past compliance with specified conditions relating to the agricultural activities of the entity.

Examples—not government grants

Ex 6 **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 in exchange for a fee 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 7 **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 entities in that jurisdiction, regardless of whether they comply with specified conditions relating to operating activities.

Ex 8 **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. The resource is not given in return for compliance with specified conditions relating to the entity's operating activities.

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—distinguishing from normal trading transactions

Ex 9 **In 20X7, an entity provided catering and cleaning services to the government under a contract that produced 30% of its revenue for the year. The government uses the services of this 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 to the rate it charges its other large customers as a result of its negotiation process. Further, the entity was entitled to an additional fee amounting to 10% of the rate it negotiated with the government.**

The premium paid by the government over the normal market rate as a result of its negotiation process is not a government grant. Unless the entity can clearly distinguish that such premium is not a normal trading transaction, this is excluded from Section 24.

The additional 10% fee 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.

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 10 **In 20X7, the entity erected a factory building in a development zone. In accordance with a government incentive scheme designed to encourage investment in manufacturing capacity in development zones, 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 the development zone, depreciation of factory buildings is recognised as an expense in the determination of taxable profit on the straight-line basis over 40 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 (accelerated tax allowance) is not accounted for as a government grant. It is accounted for in accordance with Section 29 *Income Tax*.

Ex 11 **The facts are the same as in Example 10. However, in this example, the entity is entitled to write off 150% of the cost of the building immediately for the purpose of determining its taxable income for the year ended 31 December 20X7.**

The government assistance (immediate tax deduction equal to 150% 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 12 **The facts are the same as in Example 10. However, in this example, instead of an accelerated tax allowance, the entity is entitled to a tax holiday (that is, the entity is not required to pay income tax on what would otherwise be its taxable income) for the tax years ended 31 December 20X7 and 31 December 20X8.**

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

Ex 13 **The facts are the same as in Example 10. However, in this example, instead of an accelerated tax allowance, the entity is entitled to pay tax at a lower rate (20% instead of 40%) for the tax years ended 31 December 20X7 and 20X8.**

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

Ex 14 **The facts are the same as in Example 10. However, in this example, instead of an accelerated tax allowance, the entity was granted 100% tax relief on all import and transactional taxes otherwise incurred in erecting the factory.**

The government assistance (100% tax relief on all import and transactional taxes) is accounted for as a government grant in this Section. Import and transactional taxes are not based on taxable profits as determined in accordance with the rules established by the taxation authorities (see the Glossary of terms of the *IFRS for SMEs* Standard). Thus, it is not an income tax applying Section 29.

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; and

(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 either (1) not transfer the granted resource, or (2) if the resource has already been granted, then to return the granted resource in the event that a specified condition is failed. Any such requirement should have commercial substance to be regarded as a performance condition.

Examples—recognition

Ex 15 **On 1 January 20X7, an entity received CU500,000 from a national government as an incentive to establish a manufacturing plant in a designated development zone. The incentive is conditional on the plant being erected in the development zone, meeting certain specifications and commercial production having started on or before 31 December 20X8. If any one (or more) of 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 must be recognised as a liability on 1 January 20X7 (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).

Considering the performance conditions in this example, the entire grant is at risk if any one of the conditions is not met. Consequently, it is not appropriate to recognise the income on a proportionate basis.

Paragraph 24.4(b) explicitly require that a grant is recognised in income when future performance conditions are met. Consequently, it is not appropriate to reduce the carrying amount of the plant by the CU500,000 government grant.

Ex 16 **The facts are the same as in Example 15. However, in addition to the previous conditions, the entity must also keep employment at a specified level for three years from the date production commences (30 March 20X8). The full grant must be repaid if the entity fails to meet any of the conditions.**

The grant cannot be recognised in income until all the conditions are satisfied, and therefore will only be recognised at the end of the three-year period provided the employment criteria were not breached at any time during that three-year period).

Ex 17 **The facts are the same as in Example 15. However, in addition to the previous conditions, the entity must also keep employment at a specified level for three years from the date production commences (30 March 20X8). The amount repayable in the event of breaching the employment condition proportionately reduces with the passage of time.**

The grant would be recognised in profit or loss as the grant becomes non-repayable (evenly over the three-year period).

Ex 18 **The facts are the same as in Example 15. However, in this example, assume the grant is conditional upon the plant remaining in commercial production for five years from the date on which it was first brought into use, and that in the event of any condition being unmet, the entire amount of the grant is refundable.**

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 19 **The facts are the same as in Example 15. 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 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 20 **On 1 January 20X7, a local government granted the entity, free of charge, a licence to broadcast TV content in a particular city for a 10-year period. The terms of the grant of the licence require the entity to broadcast specific types of TV 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, at fair value, a liability for the government grant (see paragraph 24.5) and an asset for the licence (see paragraph 24.4(c)). For each day the entity satisfies the performance conditions—broadcasting the specified types of programmes for at least 20 hours—1/3,650 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 21 **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 local entity that received the third broadcasting licence must measure the government grant at fair value on initial recognition. The price paid by the independent third parties of CU100,000 is strongly indicative of fair value, however consideration should be given to all of the evidence available.

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

Ex 22 **In 20X7 an entity provided catering and cleaning services under a contract with the local government that amounted to 30% of its annual revenue. 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 government pays for the services at an hourly rate that is 50% above the rate charged to other customers of the entity. The total amount received from the government in 20X7 is CU150,000. The entity has to report its roster of employees on a quarterly basis to the government. In any given quarter, should the specified condition not be met, this automatically reduces the rate the entity receives comparable to its other customers.**

The excess paid by the government over the normal market rate (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.

In accordance with Section 23 *Revenue* the rest of the amount paid by the government (CU100,000) is treated as revenue arising from the rendering of services.

Ex 23 **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 of CU500 from the government for a period of three years. The market rate of interest for similar loans is 5% per year (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.

Applying Section 11 *Basic Financial Instruments* the entity measures the loan on initial recognition at CU431.92, which is the present value of the loan (financial liability)—CU500/$(1.05)^3$.

CU68.08, the difference between the CU500 received (the loan's face value) and CU431.92, is a government grant and is recognised immediately as there are no specified future performance conditions.

The amount recognised on day one will accrete to CU500 over the three-year term using the effective interest method.

The journal entry on initial recognition is:

Dr	Cash	CU500.00	
	Cr Loan (financial liability)		CU431.92
	Cr Income (profit or loss)		CU68.08

To recognise the interest-free loan at fair value and the receipt of a government grant.

The journal entry a year after initial recognition is:

Dr	Finance cost (profit or loss)	CU21.60[a]	
	Cr Loan (financial liability)		CU21.60

To recognise accretion of time value on the financial liability.

(a) CU431.92 x 5%

The journal entries at the end of years 2 and 3 are follows:

Year 2

Dr	Finance cost (profit or loss)	CU22.68[a]	
	Cr Loan (financial liability)		CU22.68

To recognise accretion of time value on the financial liability.

(a) CU453.52 (CU431.92, initial carrying amount + CU21.60, first year accretion) x 5%

Year 3

Dr	Finance cost (profit or loss)	CU23.80[a]	
	Cr Loan (financial liability)		CU23.80

To recognise accretion of time value on the financial liability.

(a) CU476.20 (CU453.52 + CU22.68) x 5%

Dr	Loan (financial liability)	CU500.00	
	Cr Cash		CU500.00

To recognise repayment of the loan to the government.

Immediately after all the accretions are recognised, the carrying amount of the loan is equal to its face value of CU500, which is also the amount payable to the government.

Ex 24 **The facts are the same as those in Example 23. However, in this example, instead of the loan being interest-free the government charges 2% per year interest on the loan (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% 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 CU500 and 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	Cash	CU500.00	
	Cr Loan (financial liability)		CU459.15
	Cr Income (profit or loss)		CU40.85

To recognise the interest-free loan at fair value and the receipt of a government grant.

Ex 25 **The facts are the same as those in Example 23. However, in this example, there is a future performance condition attached to the interest-free loan. The entity is required to use local materials in its manufacturing process during the term of the loan.**

On initial recognition, applying Section 11, the loan is recognised at the present value of future payments. The difference between this amount and the cash received is a government grant, but instead of recognising the government grant as income, the entity will recognise it as a liability. Subsequently, assuming the future condition is met evenly, the government grant of CU68.08 will be recognised as income evenly over three years.

The journal entry on initial recognition and subsequent accounting of the government grant is:

At initial recognition:

Dr	Cash	CU500.00	
	Cr Loan (financial liability)		CU431.92
	Cr Deferred government grant (nonfinancial liability)		CU68.08

To recognise the interest-free loan at fair value and the receipt of the conditional government grant.

Subsequent measurement:

Dr	Deferred government grant (nonfinancial liability)	CU22.69[(a)]	
	Cr Income (profit or loss)		CU22.69

To recognise the government grant as income over the future performance condition.

(a) CU68.08 divided over three years

Dr	Finance cost (profit or loss)	CU21.60[(a)]	
	Cr Loan (financial liability)		CU 21.60

To accrete the difference on the loan using the effective interest method.

(a) CU431.92 x 5%

Disclosures

24.6 An entity shall disclose the following:

(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; and

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

Example—disclosures

Ex 26 **An entity can make the following disclosures related to the government grants it has received:**

Reference in *IFRS for SMEs* Standard

XYZ Ltd.

[Extract from] Consolidated statement of financial position

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

XYZ Ltd.

[Extract from] Consolidated statement of comprehensive income

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

XYZ Ltd.

[Extract from] Notes

Reference in *IFRS for SMEs* Standard

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 received or 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 reasonably 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 a film is not produced. **24.6(a) & (b)**

In 20X2 the entity's managers attended the Cannes film festival to promote the entity's latest local-language film. To promote overseas interest in the film, the local government provided free support to management, which involved helping the entity 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)**

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)**

(a) Depending on the materiality of the government grant against other items of profit or loss, an entity may present the grant recognised as income as a separate line item in the statement of comprehensive income.

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.

Notes

In cases where a loan is repayable on demand at a nil or low interest rate, no government grant is recognised because the fair value of the loan is equal to the amount received (see paragraph 12.11).

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs* Standard to transactions and events often requires the exercise of judgement, including making estimates. Information about significant judgements made by an entity's management and key sources of estimation uncertainty are useful when assessing an entity's financial position, performance and cash flows. Consequently, in accordance with paragraph 8.6, an entity must disclose the judgements—apart from those involving estimates—that its management has made when applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Furthermore, applying 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* Standard require disclosure of information about particular judgements and estimation uncertainties.

Measurement

An entity that applies the *IFRS for SMEs* Standard 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, so little difficulty will be encountered in determining the fair value. However, preparers may need to apply significant judgement in measuring the fair value of a government grant in certain circumstances (for example, 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 knowledgeable, willing buyers and sellers, involving similar assets or services).

Module 24—Government Grants

COMPARISON WITH FULL IFRS STANDARDS

When accounting for and reporting government grants and other forms of government assistance for periods beginning on 1 January 2017, the main differences between the requirements of full IFRS Standards (see IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*) and the *IFRS for SMEs* Standard (see Section 24 *Government Grants*) are:

- The *IFRS for SMEs* Standard is drafted in simple language with less application guidance than is provided in full IFRS Standards.
- In the *IFRS for SMEs* Standard, Section 24 applies to all government grants. In full IFRS Standards, IAS 41 specifies requirements for government grants that are related to a biological asset measured at fair value less costs to sell; IAS 20 applies to all other government grants.
- For a government grant that is related to a biological asset measured at fair value less costs to sell, the requirements under the *IFRS for SMEs* Standard are consistent with the requirements of IAS 41.
- For other government grants (those within the scope of IAS 20), recognition and measurement principles in full IFRS Standards differ from those in the *IFRS for SMEs* Standard as follows:
    - IAS 20 contains numerous options for accounting for government grants. The *IFRS for SMEs* Standard 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 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. Section 24 requires government grants to be recognised as income when specified future performance conditions are met independent of the entity's recognition of the related costs for which the grants are intended to compensate.
    - 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* Standard (intangible assets received by way of government grant are accounted for under Section 18 *Intangible Assets other than Goodwill*).

- For other government grants (those within the scope of IAS 20) the presentation requirements in full IFRS Standards differ from those in the *IFRS for SMEs* Standard as follows:
    - IAS 20 contains specific requirements for the presentation of government grants. IAS 20 permits two methods for presenting 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 presenting government grants related to income in the statement of comprehensive income—either separately (or under a general heading such as 'other income') or deducted when reporting the related expense.

The *IFRS for SMEs* Standard does not specify any methods for presenting 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 be inconsistent with the requirements in other sections of the *IFRS for SMEs* Standard for accounting for those assets. In any case, the *IFRS for SMEs* Standard requires entities to disclose how government grants are presented in financial statements.

Module 24—Government Grants

TEST YOUR KNOWLEDGE

Test your knowledge of the requirements for accounting for and reporting government grants and other forms of government assistance applying the *IFRS for SMEs* Standard by answering the questions provided.

You should assume that all amounts mentioned are material.

Once you have completed the test, check your answers against those set out beneath it.

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

The recognition and measurement requirements of Section 24 exclude:

☐ (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) applying 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) in either (a) or (b) 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 a government grant 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 because of the entity's performance and there are no future performance conditions attached to the grant.

The entity shall account for the government grant by:

- ☐ (a) recognising CU90,000 in income on 1 January 20X1.
- ☐ (b) recognising CU90,000 in income evenly over the nine-year period of the licence—CU10,000 per year.
- ☐ (c) crediting 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 by:

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

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

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

☐ (d) recognising 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 by:

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

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

☐ (c) crediting 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. To promote overseas trade for that industry, the national government provided free support to the management including helping them design their 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 and what promotional literature the management should give to those attending the fair. This 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 (by indicating 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. For government assistance upon which a value cannot reasonably be placed, the disclosure requirements in paragraph 24.6(c) apply.
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. The value of the government grant is derived from the activities the entity is allowed to exclusively engage in (taxi services), in each of the future nine years. This value is thus granted and consumed in each of the years as the entity performs those activities. If, at any point, the entity fails to meet the conditions of the licence, the licence is revoked in its entirety and the entity would lose all its future benefits after that point. However, even though it loses the whole of the licence, it does lose the past business benefits it had from operating under the licence. Accordingly, the entity may recognise an asset and a liability at the time the license is granted and reverse the liability to income evenly over each of the nine-year term.
Q9 (a) See paragraph 24.4(a) and 24.5.
Q10 (b) See paragraph 24.2 and 24.6(c).

APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements for accounting for and reporting government grants and other forms of government assistance applying the *IFRS for SMEs* Standard by completing the case studies provided.

Once you have completed a case study, check your answers against those set out beneath it.

Case study 1

On 1 January 20X7, SME A received a CU1,000,000 grant from the national government as an incentive to establish and operate a manufacturing plant in a development zone.

CU600,000 of the grant is conditional on SME A erecting a 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 CU600,000 to the national government.

CU400,000 of the grant is conditional on SME A maintaining commercial production at the plant for a period of four years from the date 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. On 31 December 20X7, the funds related to the grant are remitted to SME A.

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. 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 production began, the plant has operated profitably. 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.

Answer to Case study 1

During 20X7

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

To recognise the cost of plant constructed.

31 December 20X7

Dr	Cash	CU1,000,000	
	Cr Liability-deferred government grant		CU1,000,000

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

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 (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-deferred government grant	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 (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 (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 development zone. Funds are remitted from the government to SME B when SME B incurs the expenditure.

CU600,000 of the grant is conditional on the entity erecting a plant costing at least CU2,000,000 in the development zone and the plant commencing commercial production on or before 31 December 20X8.

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—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.

If these conditions are not complied with, SME B will be obliged to refund the national government proportionately for each month the performance condition is not met (CU8,333.33 per month).

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 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 production began, the plant has operated profitably. SME B intends to continue operating the plant on a commercial basis for the foreseeable future.

During 20X8, in accordance with the national government's incentive scheme to increase the export of goods manufactured in the 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
[Extract from] Consolidated statement of financial position
at 31 December 20X9

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

[Extract from] Notes to SME B 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. A grant received before the income recognition criteria are satisfied is presented as a separate liability in the statement of financial position.

Note 5 Profit before tax[g]

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 are not part of the actual disclosures in the financial statements.

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

(b) 48-month grant period minus 9 months recognised to 31 December 20X8 = 39 months remaining. 39 months x CU8,333.33[(f)] = CU325,000 total. CU325,000 minus 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.

(g) Depending on the materiality of the government grants against other items of profit or loss, an entity may present the grants recognised as income as a separate line item in the statement of comprehensive income.