When to recognize a government grant

Nearly each and every standard, will usually be made up of the definitions, when to recognize an asset or a liability, how to measure such liability asset or expense, and then there would be the disclosures.

Government grants including non-monetary grants shall not be recognised until there is reasonable assurance that ….. (Paragraph 7). Both the conditions need to be met in order to recognize a government grant in the financial statement. Even though something falls within the definition of a government grant, but it does not meet the recognition criteria, then you cannot recognize that sum of money received as a government grant.

Eg the government will refund 40% of the expenditure incurred to development incurred to develop a new product, and there are conditions, eg the average no of employees cannot fall below 100 employees.

If there are no conditions, it is not a government grant. This money that will be provided does fall in the government grant. It should be recognised if it meets the recognition criteria of a government grant. If the company faces money problems, and during a meeting they decide to lay off some employees, with the result that the average number of employees will go below 100, then the company right now cannot recognize such money received as a government grant. In order to recognise a government grant, the first condition, the entity will need to comply with the conditions attached, and if they are contemplating that they will lay off some employees resulting in the average number to go below 100, then the condition will not be met, so it will not avail itself to get such a government grant. If it thinks it will not meet the criteria/conditions to receive such grant, then it cannot recognize such government grant even though the money to be received falls in the definition to be a government grant.

Another condition is that the government must pay; the government will pay no matter what. This would mean that the government would go bankrupt. So this one is easily met.

The standard says "reasonably assured" which refers to a concept of nearly certainty. Nearly certainty that the company will comply with such conditions, and nearly certainty that the grants will be received. It does not mean that the mirror fact that a grant is received, the recognition criteria is automatically met. There are instances where the government will pay in advance such grant, so even though a company might have received a grant, if it thinks that it will not comply with the conditions, the company cannot recognise such monies as a government grant.

Eg on 30th June 2015 accepted a claim from the company Frank PLC, to reimburse it for expenses incurred in renovating its plant. The total cost of renovating the plant amounted to 1,000,000, and the government will refund an 80% equivalent of such cost if the following 2 conditions are met; the company will start exporting into 2 new foreign markets, and the average employees over the next 3 years will increase from 150 to 220. The government transferred the 800,000 in the bank account of Frank PLC on 1st September 2015. During a board meeting, held in July, the board of directors expressed their concern as to wheatear they will be able to increase the workforce by 70 over the coming 3 years in view of the fact that demand for the company's products in mainland Europe is not that strong in view of the slow recovery of the EU's economy.

Here we are dealing with a government grant, as it ticks all the boxes for it to be recognised. The second condition was met, but is the company able to export in the foreign markets and will it is able to increase work force. In the meeting, the directors have doubts whether this will be achieved, so the directors are not reasonably assured that the conditions will be met. If they are not met, the company

Case Study 2a

The government has transferred land, and there is a condition. When the government provides a non-monetary grant (land), the company has 2 options, to show the grant at nominal value or at fair value. Fair value is to show it at the fair value of the asset I have received (so if it is 4,000,000 Dr the asset 4,000,000 and Cr the grant at 4,000,000). If they decide to show it at nominal value, they would show nothing in the books.

Dr land 25,000,000 (the credit the cost I will incur to condition the grant)
Cr Deferred Income 25,000,000 (so we allocate it over the 3 years)

We have to allocate it systematically with the expenses that are going to be incurred. 16 million is the total labour cost. During the year we incurred 4 million, so (4,000,000/16,000,000) 25%.
25% x 25,000,000 = 6,250,000. In my first year I have to release 6,250,000

Dr Deferred Income 6,250,000
Cr Other income 6,250,000

Now, we have to sub-divide between current and non-current liability. The balance as at year end is 18,750,000. Next year the labour cost is 6,000,000, so I am expecting to release 6mil/16mil x 25,000,000 = 9,375,000. SO I am going to release 9,375,000. So this amount is going to be shown as current liabilities.
The other 9,375,000 is going to be shown as non-current liabilities.

Examples

Case Study 1

You are the accountant of Dorp plc, a company listed on the Malta Stock Exchange. The principal operation of Dorp plc is the provision of specialised industrial plant and equipment. Following minimal growth in the last few years, the board of directors, during a meeting in 2013, decided that Dorp plc should look beyond the Maltese shores and target new foreign markets.

As at 1 January 2014, Dorp plc was 75% owned by private shareholders and 25% owned by the Government of Malta (partly state-owned).

Required:

The following are a series of transactions and events that took place during 2014. You are required to apply the recognition and measurement principles as per IAS 20, Accounting for Government Grants and Disclosure of Government Assistance, to account for the below transactions (i – v) or otherwise for the year ended 31 December 2014. *You should clearly include the rationale for the answers provided and the necessary journal entries to account for the above transactions.*

i. Dorp plc was planning to extend its business in the Asian market. The chairman of the Board was invited by the foreign minister of Malta to take part in a delegation visiting Japan in order to improve economic relationships. The trip, which cost amounted to EUR25,000 was paid for by the Government of Malta. During the trip, the chairman succeeded in initiating talks with another listed Japanese company, which Dorp plc hopes will be the start of a long-lasting economic relationship.

ii. On 15 May 2014, Dorp plc managed to win a major contract to provide specialised plant and equipment to a company incorporated in the United Kingdom. However, due to the enormity of this project, the UK customer requested that Dorp plc provides it with a financial guarantee of EUR3.5 million that would be triggered in case the project is not completed.

   Dorp plc met with various bankers to discuss the cost of being provided with such a financial guarantee. The cost quoted by the various bankers ranged between EUR100,000 and EUR200,000. In view of the high cost involved, Dorp plc approached a governmental business agency and the latter agreed to provide such financial guarantee, on behalf of Dorp plc, with no cost implications.

iii. Dorp plc owns a block of apartments, which it recognises as investment property. In line with IAS 40, Dorp plc values its investment property at fair value. On 1 January 2014, the fair value of the property was EUR25 million. On 1 August 2014, Dorp plc entered into an agreement with the Government of Malta to lease such property for a period of 10 years to lessees that qualify for social housing.

   In line with this, the Government of Malta agreed to provide Dorp plc with a grant of EUR3 million covering the whole 10 years that is intended to compensate the entity for the lower rent it will receive when the property is let as social housing at below the market rates.