

1 Government grants (Lecture A685 – 10.04 minutes)

Government grants are dealt with in FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* in Section 24 *Government Grants* and in Section 19 *Government Grants* in FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*. Issues relating to micro-entities that receive government grants are dealt with later.

1.1 Scope of section 24

Section 24 of FRS 102 deals with the accounting requirements for all government grants. The term 'government grants' is defined in the Glossary to FRS 102 as:

*Assistance by 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.*

FRS 102 Glossary
government grant

Government refers to government, government agencies and similar bodies whether local, national or international.

Government grants do not include forms of government assistance which cannot reasonably have a value placed on them, nor does Section 24 include transactions with government which cannot be distinguished from the normal trading transactions of the entity.

FRS 102, para 24.3 confirms that Section 24 does not deal with government assistance which is provided to an entity in the form of benefits which are available in determining the entity's taxable profit (or loss). The section itself cites examples of such government assistance which include:

- income tax holidays;
- investment tax credits;
- accelerated depreciation allowances; and
- reduced income tax rates.

1.2 Recognition and measurement

A reporting entity cannot recognise a government grant until the recognition criteria has been met. In order to meet the recognition criteria, there must be reasonable assurance that:

- the entity will comply with the conditions attaching to the grant; and
- the grants will be received.

The term 'reasonable assurance' is used in FRS 102, para 24.3A but the standard does not define it and this raises the question as to whether it should be taken to have the same meaning as 'probable' (which is defined in the standard as 'more likely than not'). In the context of government grants, it would not be unreasonable

to assume that 'reasonable assurance' has the same meaning attributed to it as 'probable'.

Example – Recognition criteria not met

Summer Limited has a year end of 31 December 2019 and on 30 November 2019 it applied for a government grant towards the cost of expenses incurred in training seven apprentices. The application confirms that the government will only agree to reimbursement of these expenses at its discretion. At the balance sheet date the company had not been given confirmation as to whether its application had been successful or not.

The financial controller has nonetheless included a debtor in respect of the grant due from the government and has taken the corresponding entry to profit and loss. She has done this on the basis that a customer has confirmed that they were successful in obtaining a similar grant.

The financial controller is incorrect to recognise a debtor in the financial statements for the year ended 31 December 2019 because at the reporting date the company was unsure whether, or not, the grant would be received from the government (confirmation was not received from the government). Therefore, the debtor should be reversed and accounted for in the financial statements for the year ended 31 December 2020 if it is received.

Where the recognition criteria are met by the reporting date, then the grant is measured at the fair value of the asset received or receivable. If any of the grant is repayable (or becomes repayable) by the year-end, then a liability is recognised when the repayment meets the definition of a liability.

1.3 Accrual and performance models

An entity receiving (or expecting to receive) a government grant that meets the recognition criteria laid down in FRS 102, para 24.5D is required to recognise the grant based on the accrual model or the performance model. This is an accounting policy choice and must be applied on a class-by-class basis.

It must be noted that micro-entities choosing to report under FRS 105 cannot apply the performance model. They must only use the accrual model.

Accrual model

The accrual model of grant recognition will be the most familiar to accountants. This model requires the grant to be classified as either a revenue-based grant or a capital-based grant.

According to FRS 102, para 24.5D, grants which relate to revenue shall be recognised in income on a systematic basis over the periods in which the entity recognises the related costs for which the grant is intended to compensate.

Example – Grant received for costs already incurred

Spring Ltd has applied for a grant towards the cost of employing 100 members of a community where unemployment is very high. The terms of the grant application have been met and the grant has been agreed by the government. The grant was received after the year end date had passed but confirmation that it was receivable was received prior to the year end.

A grant which becomes receivable as compensation for expenses (or losses) which have already been incurred is recognised within income in the period in which it becomes receivable. Therefore, the entity recognises the grant as income when the government confirms its agreement to providing the grant – i.e. in the current year, not in the succeeding year when the company physically receives the grant.

Grants which relate to assets (i.e. capital-based grants) are recognised in income on a systematic basis over the expected useful life of the asset.

Example – Capital-based grant

Autumn Ltd (Autumn) has purchased a new item of machinery for £100,000 outright in cash which has an estimated residual value of £nil at the end of its useful economic life. The machine is being depreciated in accordance with the company's accounting policy for such equipment, being 10 years on a straight-line basis with a full year's depreciation charge in the year of acquisition, but none in the year of disposal.

Autumn applied for a government grant towards the cost of this asset and the government have confirmed that they will meet 20% of the cost of the equipment in the form of a grant (i.e. a grant of £20,000). This has been received by the company two weeks after the purchase of the machine.

The entries in the books of the company in respect of the new machine and the grant are as follows:

Purchase of the machine

Dr Property, plant and equipment additions	£100,000
Cr Cash at bank	£100,000

Being purchase of new machine

Dr Depreciation expense (profit and loss)	£10,000
Cr Accumulated depreciation (balance sheet)	£10,000

Being depreciation of new machine in year 1

Government grant

Dr Cash at bank	£20,000
Cr Deferred income	£20,000

Being initial receipt of the government grant

Dr Deferred income	£2,000
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Cr Profit and loss account (other income)	£2,000
<i>Being 1/10th of the grant released to profit or loss</i>	

It should be noted that FRS 102, paragraph 24.5G specifically prohibits the value of the capital-based grant from being deducted from the cost of the asset (i.e. Dr Bank, Cr PPE additions) and hence recognising the grant in profit and loss by way of reduced depreciation charges. This is because such an accounting treatment is incompatible with company law because the statutory definitions of 'purchase price' and 'production cost' make no provisions for deductions from such amounts.

Performance model

The performance model is dealt with in FRS 102 at paragraph 24.5B.

Where the entity has an accounting policy of applying the performance model, a grant is recognised in the financial statements as follows:

- (a) *A grant that does not impose specified future **performance-related conditions** on the recipient is recognised in income when the grant proceeds are received or receivable.*
- (b) *A grant that imposes specified future performance-related conditions on the recipient is recognised in income only when the performance-related conditions are met.*
- (c) *Grants received before the **revenue recognition** criteria are satisfied are recognised as a liability.*

FRS 102 para 24.5B

Example – Performance-related conditions met

Winter Ltd has set up a new branch in a deprived area of the country and has an accounting reference date of 31 March each year. In order to entice businesses to set up operations, the government have introduced a scheme whereby it will provide a grant to the company once certain conditions have been met. The conditions are as follows:

- The company must be trading to full capacity by 31 December 2019.
- The company must have successfully employed at least 150 people on a full-time basis by 31 January 2020.
- The company must take on at least 25 people under the age of 25 on an apprenticeship scheme.

The company successfully achieved all the conditions imposed on them by the government and the grant was duly received on 26 March 2019. The financial controller is unsure whether to recognise the whole grant in profit or loss or defer it in the balance sheet.

The company has complied with all its performance-related conditions imposed on it by the government where the grant is concerned. Provided none of the grant is, or may become, repayable in the future, the entire grant can be recognised in income for the year ended 31 March 2019.

1.4 Micro-entities

FRS 105, Section 19 *Government Grants* outlines the accounting requirements for government grants. Micro-entities choosing to report under FRS 105 cannot use the performance model for grants and instead must only use the accrual model. Micro-entities must still classify government grants as either revenue-based or capital-based and account for them in the same way as entities reporting under FRS 102. Any grants which are, or become, repayable must be recognised as a liability when the repayment meets the definition of a liability.

1.5 Disclosures

The disclosure requirements in respect of grants are as follows:

- (a) the **accounting policy** adopted for grants in accordance with paragraph 24.4;
- (b) the nature and amounts of grants recognised in the **financial statements**;
- (c) unfulfilled conditions and other contingencies attaching to grants that have been recognised in income; and
- (d) an indication of other forms of government assistance from which the entity has directly benefited.

FRS 102 para
24.6(a) to (d)

FRS 102 para 24.7

For the purpose of the disclosure required by paragraph 24.6(d), 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 and the provision of guarantees.