

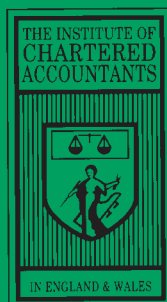
SSAP

Statement of standard accounting practice No. 4.

4

Revised July 1990

Accounting for government grants



STATEMENT OF STANDARD ACCOUNTING PRACTICE

SSAP4 (Revised)

Accounting for government grants

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STATEMENT OF STANDARD ACCOUNTING PRACTICE

Accounting for government grants

(Issued April 1974, revised July 1990)

The provisions of this statement of standard accounting practice should be read in conjunction with the Explanatory Foreword to accounting standards and need not be applied to immaterial items.

Part 1 – Explanatory note

Introduction

- 1 Government assistance takes many forms, including grants, equity finance, subsidised loans and advisory assistance. This statement deals with the accounting treatment and disclosure of government grants and other forms of government assistance. It is also indicative of best practice for accounting for grants and assistance from other sources.
- 2 Government grants are made in order to persuade or assist enterprises to pursue courses of action which are deemed to be socially or economically desirable. The range of grants available is very wide and changes regularly, reflecting changes in government policy. More significantly, different grants tend to be given on different terms as to eligibility, manner of determination, manner of payment and conditions to be fulfilled. While this statement has been written in the context of the grants available at the time of its preparation, it is intended that it will be equally applicable to other grants that may be created in the future.
- 3 For the purposes of this statement, the term ‘government’ is defined widely. Thus, it includes not only the national government and all of the various tiers of local and regional government of any country, but also government agencies and ‘non-departmental public bodies’ (or quangos). It also includes the Commission of the European Communities and other EC bodies, together with other international bodies and agencies.

Basic concepts

- 4 The ‘accruals’ concept requires that revenue and costs are accrued, matched with one another so far as their relationship can be established or justifiably assumed, and dealt with in the profit and loss account of the period to which they relate. Government grants should therefore be recognised in the profit and loss account so as to match them with the expenditure towards which they are intended to contribute.
- 5 The ‘prudence’ concept requires that revenue and profits are not anticipated, but are recognised by inclusion in the profit and loss account only when realised in the form either of cash or of other assets the ultimate cash realisation of which can be established with reasonable certainty. Accordingly, government grants should not be recognised in the profit and loss account until the conditions for their receipt have been complied with and there is reasonable assurance that the grant will be received.
- 6 In many cases, the grant-making body has the right to recover all or part of a grant paid if the enterprise has not complied with the conditions under which the grant was made. On the assumption that the enterprise is a going concern, the application of the prudence

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concept does not normally require postponement of the recognition of the grant in the profit and loss account solely because there is a possibility that it might have to be repaid in the future. The enterprise should consider regularly whether there is a likelihood of a breach of the conditions on which the grant was made. If such a breach has occurred, or appears likely to occur, and it is probable that some grant will have to be repaid, provision should be made for the liability.

The treatment for taxation purposes of government grants varies according to the terms of the grant and the particular statute or regulation under which it is made. At one extreme, some grants are free of all tax; at the other, some are taxed as income on receipt. It is sometimes suggested that because grants are taxed as income on receipt they are intended to be regarded as income and should be credited to the profit and loss account as they are received. However, the treatment of an item for tax purposes does not necessarily determine its treatment for accounting purposes, and immediate recognition in the profit and loss account may result in an unacceptable departure from the principle that government grants should be matched with the expenditure towards which they are intended to contribute. Any timing differences that may arise between a tax charge and the recognition of the corresponding credit in the profit and loss account should be dealt with in accordance with SSAP15 'Accounting for deferred tax'.

Establishing the relationship between grants received and expenditure

The matching of grants received and expenditure is straightforward if the grant is made as a contribution towards specified items of expenditure (whether capital, revenue or a particular combination) and is described as such.

Difficulties arise where the terms of the grant do not specify precisely the expenditure it is intended to meet, but use such phrases as 'to assist with a project' or 'to encourage job creation', or where the basis of calculation is related to two or more criteria (for example the capital expenditure incurred and the number of jobs created). In these circumstances, it is usually appropriate to consider the circumstances which give rise to the payment of instalments of the grant. If the grant is paid when evidence is produced that certain expenditure has been incurred, the grant should be matched with that expenditure. If the grant is paid on a different basis, it will usually be paid on the achievement of a non-financial objective, such as the creation of a specified number of new jobs; in these circumstances, the grant should be matched with the identifiable costs of achieving that objective, for example the cost of creating and, if applicable, maintaining for the required period the specified new jobs.

In some cases, there may be persuasive evidence that the actual expenditure towards which the grant is intended to contribute differs from the expenditure that forms the basis of payment. Such evidence may be contained in the formal application for the grant and subsequent correspondence and negotiation with the grant-making body. Where such evidence exists and is sufficiently persuasive, it is appropriate to match the grant received with the identified expenditure and this approach should be preferred to that outlined in the previous paragraph. For example, a discretionary grant might be given 'to assist with a project', with instalments of the grant being payable on the production of evidence that specific capital expenditure had been incurred; but it might be clear from correspondence that the grant had been made as a contribution to other costs as well, such as the provision of working capital or the meeting of initial training costs.

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- 11 Where a grant is paid on the achievement of a non-financial objective, the costs of achieving that objective must be identified or estimated on a reasonable basis. For example, if a grant is given on condition that jobs are created and maintained for a minimum period, the grant should be matched with the cost of providing jobs for that period, taking due account of the incidence of the costs incurred. As the costs of job creation will often be higher in the early stages of a project, because of start-up costs and the fact that a significant element of wage costs will initially be non-productive, the matching principle may require that an equivalent, higher proportion of the grant should be recognised in the earlier periods.

Recognition of grants in the profit and loss account

- 12 Once the relationship between the grant and the related expenditure has been established, the recognition of the grant in the profit and loss account will follow. The grant should be recognised in the same period as the related expenditure.
- 13 In certain circumstances, government grants may be given for the immediate financial support or assistance of an enterprise or for the reimbursement of costs previously incurred, without conditions regarding the enterprise's future actions or a requirement to incur further costs. Government grants may also be given to finance the general activities of an enterprise over a specified period or to compensate for a loss of income; in some instances, the extent of these grants may be such as to constitute a major source of income for the enterprise. Grants that are payable on this basis should be recognised in the profit and loss account of the period in respect of which they are paid or, if they are not stated to be paid in respect of a specified period, in the profit and loss account of the period in which they become receivable.
- 14 Where an enterprise is required to repay a government grant, either in whole or in part, the full amount to be repaid, after taking into account any unamortised deferred income relating to the grant, should be charged to the profit and loss account immediately it becomes repayable. Where appropriate, the repayment should be dealt with in accordance with SSAP6 'Extraordinary items and prior year adjustments'.

Balance sheet treatment of grants

- 15 The application of this statement may result in part or all of a grant that has been received not being recognised immediately in the profit and loss account. Any unrecognised amounts should normally be included in the balance sheet as deferred income. Where a grant is made as a contribution towards expenditure on fixed assets, there are two possible balance sheet treatments, both of which result in the grant being matched with the related expenditure in the profit and loss account. These are:
- (a) to treat the amount of the grant as deferred income which is credited to the profit and loss account by instalments over the expected useful economic life of the related asset on a basis consistent with the depreciation policy; or
 - (b) to deduct the amount of the grant from the purchase price or production cost of the related asset, with a consequent reduction in the annual charge for depreciation.

It is considered that both treatments are acceptable and are capable of giving a true and fair view. However, the CCAB has received Counsel's opinion that paragraphs 17 and 26 of Schedule 4 to the Companies Act 1985 have the effect of prohibiting enterprises to

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- which the legislation applies from accounting for grants made as a contribution towards expenditure on fixed assets by deducting the amount of the grant from the purchase price or production cost of the related asset.
- Where a government grant takes the form of a transfer of non-monetary assets, the amount of the grant is the fair value of the assets transferred. 16
- Disclosure**
- The financial statements should disclose the accounting policy adopted in respect of government grants in terms which make clear the method or methods adopted. The period or periods over which grants are credited to the profit and loss account should be disclosed insofar as this is practicable given the number and variety of grants that are being received. Normally, it will be sufficient to give a broad indication of the future periods in which grants already received will be recognised in the profit and loss account. 17
- Where the results for the period have been affected materially by amounts credited in respect of government grants, and/or where the results of future periods are expected to be affected materially by the the recognition in the profit and loss account of grants already received, it is important for an understanding of the financial statements that the effects on the results or the financial position of the enterprise should be disclosed. 18
- Government assistance to an enterprise may also be given in a form other than grants, for example consultancy and advisory services, subsidised loans and credit guarantees. Where such assistance has had a material effect on the results for the period, the nature and, where measurable, the effects of the assistance should be disclosed. 19
- Under SSAP18 'Accounting for contingencies' potential liabilities to repay grants should only be provided for to the extent that repayment is probable. A material contingent loss not so provided for should be disclosed, except where the possibility of repayment is remote. 20

Part 2 – Definition of terms

- Government* includes government and inter-governmental agencies and similar bodies whether local, national or international. 21
- Government grants* are assistance by government in the form of cash or transfers of assets to an enterprise in return for past or future compliance with certain conditions relating to the operating activities of the enterprise. 22

Part 3 – Standard accounting practice

- Subject to paragraph 24 of this statement, government grants should be recognised in the profit and loss account so as to match them with the expenditure towards which they are intended to contribute. In the absence of persuasive evidence to the contrary, government grants should be assumed to contribute towards the expenditure that is the basis for their payment. To the extent that grants are made as a contribution towards specific expendi- 23

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ture on fixed assets, they should be recognised over the expected useful economic lives of the related assets. Grants made to give immediate financial support or assistance to an enterprise or to reimburse costs previously incurred should be recognised in the profit and loss account of the period in which they become receivable. Grants made to finance the general activities of an enterprise over a specific period or to compensate for a loss of current or future income should be recognised in the profit and loss account of the period in respect of which they are paid.

- 24 The foregoing requirements are subject to the proviso that a government grant should not be recognised in the profit and loss account until the conditions for its receipt have been complied with and there is reasonable assurance that the grant will be received.
- 25 Where the recognition in the profit and loss account of part or all of a grant that has been received is deferred, the amount so deferred should be treated as deferred income. To the extent that the grant is made as a contribution towards expenditure on a fixed asset, in principle it may be deducted from the purchase price or production cost of that asset. The CCAB has received Counsel's opinion, however, that the option to deduct government grants from the purchase price or production cost of fixed assets is not available to companies governed by the accounting and reporting requirements of the Companies Act 1985, as outlined in paragraph 34.
- 26 Grants relating to leased assets in the accounts of lessors should be accounted for in accordance with the requirements of SSAP21 'Accounting for leases and hire purchase contracts'.
- 27 Potential liabilities to repay grants either in whole or in part in specified circumstances should only be provided for to the extent that repayment is probable. The repayment of a government grant should be accounted for by setting off the repayment against any unamortised deferred income relating to the grant. Any excess should be charged immediately to the profit and loss account.

Disclosure

- 28 The following information should be disclosed in the financial statements:
- (a) the accounting policy adopted for government grants;
 - (b) the effects of government grants on the results for the period and/or the financial position of the enterprise;
 - (c) where the results of the period are affected materially by the receipt of forms of government assistance other than grants, the nature of that assistance and, to the extent that the effects on the financial statements can be measured, an estimate of those effects.
- 29 Potential liabilities to repay grants in specified circumstances should, if necessary, be disclosed in accordance with paragraph 16 of SSAP18 'Accounting for contingencies'.

Transitional provisions

- 30 Any adjustments arising as a result of a change in accounting policy to comply with the requirements of this statement should be accounted for in accordance with paragraph 18 of SSAP6 'Extraordinary items and prior year adjustments'.

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Date from which effective

The accounting practices set out in this statement should be adopted as soon as possible. They should be regarded as standard accounting practice in respect of financial statements relating to accounting periods beginning on or after 1 July 1990. 31

Part 4 – Legal requirements in Great Britain and Northern Ireland

References are to the Companies Act 1985 and the Companies (Northern Ireland) Order 1986.

The balance sheet formats in Schedule 4 require that accruals and deferred income should be shown either under the heading 'Creditors' or separately as 'Accruals and deferred income'. This is relevant to the disclosure of deferred income in relation to government grants. (Standard paragraph 25) 32

Paragraph 12 of Schedule 4 requires that the amount of any item shall be determined on a prudent basis and, in particular, that only profits realised at the balance sheet date shall be included in the profit and loss account. (Paragraph 91 of the Schedule defines realised profits in relation to a company's accounts as 'such profits of the company as fall to be treated as realised profits for the purposes of those accounts in accordance with principles generally accepted with respect to the determination for accounting purposes of realised profits at the time when those accounts are prepared'.) (Standard paragraph 24) 33

Paragraph 17 of Schedule 4 requires that, subject to any provision for depreciation or diminution in value, the amount to be included in the balance sheet in respect of any fixed asset shall be its purchase price or production cost. Paragraph 26(1) states that the purchase price of an asset shall be determined by adding to the actual price paid any expenses incidental to its acquisition. The CCAB has received Counsel's opinion that these paragraphs have the effect of prohibiting enterprises to which the legislation applies from accounting for grants made as a contribution towards expenditure on fixed assets by deducting the amount of the grant from the purchase price or production cost of the related asset. (Standard paragraph 25) 34

Paragraph 50 (2) of Schedule 4 provides that 'The following information shall be given with respect to any other contingent liability not provided for: 35

- (a) the amount or estimated amount of that liability;
- (b) its legal nature; and
- (c) whether any valuable security has been provided by the company in connection with that liability and if so, what'. (Standard paragraph 29)

Part 5 – Legal requirements in the Republic of Ireland

References are to the Companies (Amendment) Act 1986 and the Schedule to that Act unless otherwise stated.

Note 8 to the balance sheet formats in the Schedule provides that government grants 36

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included in the item 'Accruals and deferred income' must be shown separately in a-note to the accounts if not shown separately in the balance sheet. However, Note 8 does not impose an obligation to include government grants under 'Accruals and deferred income' and such grants may, therefore, be placed under a separate heading. This separate heading is often placed between liabilities and share capital/reserves. If a new heading is adopted (using Section 4(12)), the requirement under Note 8 to have a separate mention of the amount is not applicable. (Standard paragraph 25)

- 37 Section 5(c) of the Act requires that the amount of any item shall be determined on a prudent basis and, in particular, that only profits realised at the balance sheet date shall be included in the profit and loss account. (Paragraph 72 of the Schedule defines realised profits in relation to a company's accounts as 'such profits of the company as fall to be treated as realised profits for the purposes of those accounts in accordance with principles generally accepted with respect to the determination for accounting purposes of realised profits at the time when those accounts are prepared'.) (Standard paragraph 24)
- 38 Paragraph 5 of the Schedule requires that, subject to any provision for depreciation or diminution in value, the amount to be included in respect of any fixed asset shall be its purchase price or production cost. Paragraph 14(1) states that the purchase price of an asset shall be determined by adding to the actual price paid any expenses incidental to its acquisition. The CCAB has received legal opinion that the equivalent paragraphs in UK legislation have the effect of prohibiting enterprises to which the legislation applies from accounting for grants made as a contribution towards expenditure on fixed assets by deducting the amount of the grant from the purchase price or production cost of the related asset. (Standard paragraph 25)
- 39 Paragraph 36(2) of the Schedule provides that 'The following information shall be given with respect to any other contingent liability not provided for:
- (a) the amount or estimated amount of that liability;
 - (b) its legal nature; and
 - (c) whether any valuable security has been provided by the company in connection with that liability and if so, what'. (Standard paragraph 29)
- 40 The Companies (Amendment) Act 1983, Section 40 requires the convening of an extraordinary general meeting not later than 28 days from the earliest day on which it is known to a director of the company that its net assets have fallen to half or less of the company's called-up share capital (that a 'financial situation' exists). The 1983 Act also extends the reporting duties of auditors by requiring auditors to state whether in their opinion there existed at the balance sheet date a 'financial situation' in the context of Section 40 which would require the convening of an extraordinary general meeting. For the purpose of calculating the net assets of the company, the term 'liability' should be taken to include not only creditors, but also provisions for liabilities and charges, accruals and deferred income. Government grants treated as deferred income should, therefore, be regarded as a liability for the purposes of calculating net assets under Section 40.

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Part 6 – Compliance with International Accounting Standard No.20 'Accounting for Government Grants and Disclosure of Government Assistance'

The requirements of International Accounting Standard No. 20 'Accounting for Government Grants and Disclosure of Government Assistance' accord very closely with the content of the United Kingdom and Irish Accounting Standard No. 4 (Revised) 'Accounting for government grants' and accordingly compliance with SSAP4 (Revised) will ensure compliance with IAS20 in all material respects. 41

