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CL-25-1 | Corporate Financial Reporting

Corporate Level (2025 – Curriculum)

- LKAS 20 – Accounting for Government Grants and Disclosure of Government Assistance

Chandima Prabhath

B.Sc. Accounting (special) First Class (USJ) | ACA | CMA Passed Finalist | MAAT | ICAEW Finalist | ACCA Finalist | CA, CMA and AAT Merit and Subject Prize winner | Certification in Forensic Accounting (CASL) | ABR Prize Winner in CA Strategic Level

LKAS 20

Accounting for Government Grants and Disclosure of Government Assistance

1. Introduction

It is common for entities to receive government grants for various purposes. The main objective of **LKAS 20** is to prescribe the appropriate accounting treatment and disclosure requirements for government grants and other forms of government assistance.

The standard ensures that government grants are recognized in **profit or loss** on a systematic basis over the periods in which the related expenses are recognized, thereby **matching** income with the associated costs.

It also provides guidance on the treatment of grants related to income and grants related to assets, promoting transparency, consistency, and fair presentation in financial statements regarding the impact of government assistance on an entity's financial position and performance.

1.2 Scope

LKAS 20 does **not** deal with:

- Accounting for government grants in financial statements reflecting the effects of changing prices
- Government assistance given in the form of 'tax breaks'
- Government acting as part-owner of the entity
- Government grants covered by LKAS 41 Agriculture

1.3 Key Definitions

Government	Government, government agencies and similar bodies whether local, national or international.
Government assistance	Action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria.
Government grants	Assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

Grants related to assets	Government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire non-current assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.
Grants related to income	Government grants other than those related to assets.
Forgivable loans	Loans which the lender undertakes to waive repayment of under certain prescribed conditions.
Fair value	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (Refer SLFRS 13)

Once you identify a government grant, we can apply a structured analysis to determine its specific classification. The main stages of this process are:

- **Stage 1: Identification** Determine whether the assistance meets the definition of a government grant by confirming there is a transfer of resources with attached conditions.

- **Stage 2: Analysis** Examine the grant agreement to assess its nature (monetary or non-monetary), evaluate any performance conditions or obligations, and identify the time period over which conditions must be met.

- **Stage 3: Classification** Categorise the grant based on its purpose as either related to assets (capital grants) or related to income (revenue grants), which determines the pattern of recognition in the financial statements.

Question 01 –Monetary and Non-Monetary Grants

Palmnest Foods, a food processing company, has agreed to set up a new manufacturing plant in a designated development zone. As an incentive, the government has provided the following support package:

- A cash payment of Rs. 75,000,000 to be used for the purchase of new processing machinery.
- A 5-acre plot of land adjacent to the new plant for future expansion. The land has a fair value of Rs. 50,000,000 at the date of transfer.

The grant requires Palmnest Foods to construct the plant and commence operations within two years, and to employ at least 150 local residents for a minimum of five years.

Required:

1. **Classify** each component of the assistance
2. **Determine** the total value of the government grants received
3. **State** the basis for classification

Question 02 – Forgivable Loan

On 1 January 2026, Trident Logic Ltd. received a loan of Rs. 20,000,000 from a government agency to fund research and development activities. The loan has the following terms:

• **Interest Rate**: 3% per annum, payable annually in arrears.

• **Loan Term**: 4 years.

• **Repayment**: The principal is repayable in full at the end of year 4.

The market interest rate for a similar loan for Trident Logic Ltd. from a commercial bank would have been **10%** per annum. The benefit of the below-market interest rate is considered a government grant.

Required:

Calculate the value of the government grant component of this loan.

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2. Accounting for government grants

The accounting treatment described below is applied to:

- Government grants
- Forgivable loans
- Loans at below-market rates of interest

The approach involves evaluating recognition criteria, applying appropriate measurement techniques, selecting presentation methods, and preparing disclosures. The accounting policies should be well-designed and consistently applied.

2.1 Recognition

Government grants are recognised when the entity has **reasonable assurance** that:

(a) It will comply with any conditions attached to the grant
(b) It will actually receive the grant

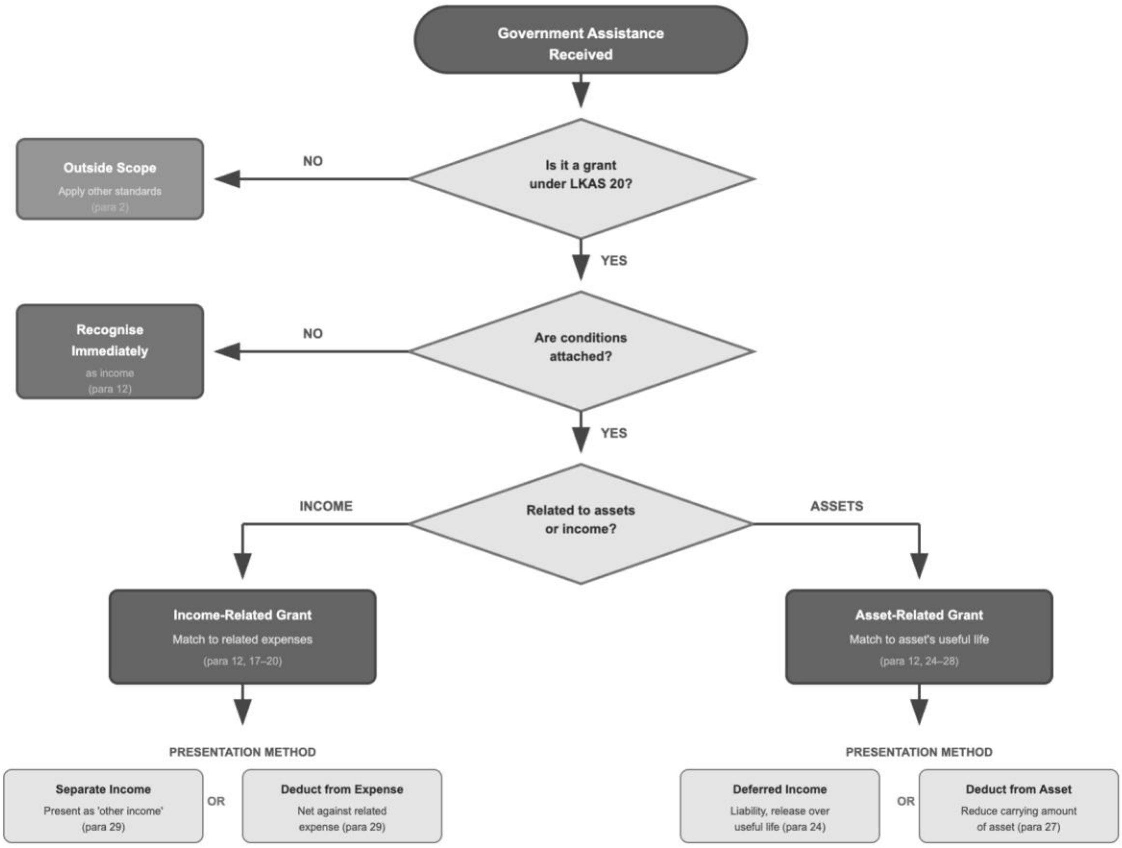

Figure 1: Grant Recognition Decision Flowchart (CFR Study Text: - Page 526)

Example: If an entity is awarded a Rs. 5 million grant to build a factory and employ 100 local staff for five years, the grant should be recognized **only when** there is reasonable assurance that both the construction and employment conditions will be fulfilled.

The **income approach** is used to account for government grants i.e. the grant received is recognised in **profit or loss** on a systematic basis over the relevant accounting periods in which the entity recognises the related costs as expenses:

- Grants for **depreciable assets** are recognised as income on the same basis as the asset is depreciated.

- Grants for **non-depreciable assets** are recognised as income over the periods in which the cost of meeting the obligation is incurred.

- A grant may be **split into parts** and allocated on different bases where there are a series of conditions attached.

- Where **related costs have already been incurred**, the grant is recognised as income in full when it becomes receivable.

Question 03 – Recognition of government grants

Explain how the following should be accounted for in so far as the information provided permits:

1. Company A receives a grant to subsidise specific expenditure that arises in the year that the grant is received.

2. Company B receives a grant to help it achieve export targets. The company expects to achieve the targets 5 years after receipt of the grant.

3. Company C receives a grant for the purchase of a specialised piece of machinery.

4. Company D receives a grant for the purchase of land. A condition of the grant is that the Company must build a property on the land.

2.2 Measurement

Monetary Grant → Measured at the **amount of grant**

Non-Monetary Grant → Measured at **fair value of the asset provided** or at a **nominal value**

e.g.
- Land Provided Free of Charge
- Free Machinery or Equipment

A loan at a below market rate of interest → Measured as the **difference** between the **initial carrying amount** of the loan (measured in accordance with SLFRS 9) and the **proceeds received**

2.3 Presentation

Grants
- Income related grants
- Assets related grants

Grants related to **assets** may be presented in the statement of financial position **either** as:

a) Deferred income; **or**
b) Deducted in arriving at the carrying amount of the asset

If recognised as deferred income, the grant is released to profit or loss as income; if recognised as a reduction in the carrying amount of the asset, the grant reduces the annual depreciation charge to profit or loss. The selected method must be applied consistently to all similar grants to ensure comparability.

Example: The following table illustrates the financial impact of each method using an example of a Rs. 10 million assets with a 10-year useful life and a Rs. 2 million government grants:

Comparison of Grant Presentation Methods		
Financial Statement Item	Deferred Income Method *(Rs.)*	Asset Deduction Method *(Rs.)*
Initial Recognition		
Non-Current Asset	10,000,000	8,000,000
Deferred Income (Liability)	2,000,000	0
Annual Impact		
Depreciation Expense	(1,000,000)	(800,000)
Grant Income	200,000	0
Net Impact on Profit	(800,000)	(Rs. 800,000)

Grants related to **income** are presented in profit or loss (the statement of profit or loss) presented **either** as:

a) A separate credit; **or**
b) Deducted from the related expense

In each case the two alternatives are equally acceptable, however it may be argued that offsetting amounts in the financial statements results in a less transparent presentation and may hinder users from fully understanding the entity's position and performance.

Question 04 – Deferred Income Method

Oceanleaf Exports receives a government grant of Rs. 2,000,000 on 1 January 2023 to purchase a specialised machine. The machine costs Rs. 10,000,000 and has a useful life of 10 years with no residual value. The company's accounting policy is to treat grants related to assets as deferred income.

Required:

1. **Identify** the accounting treatment for the initial recognition at 1 January 2023.
2. **Outline** the accounting treatment for the year ended 31 December 2023.
3. **Prepare** the financial statement extracts as at 31 December 2023.

Question 05 – Asset Deduction Method

Oceanleaf Exports receives a government grant of Rs. 2,000,000 on 1 January 2023 to purchase a specialised machine. The machine costs Rs. 10,000,000 and has a useful life of 10 years with no residual value. The company's accounting policy is to deduct the grant from the carrying amount of the asset.

Required:

1. **Identify** the accounting treatment for the initial recognition at 1 January 2023 under asset deduction method.
2. **Outline** the accounting treatment for the year ended 31 December 2023.
3. **Prepare** the financial statement extracts as at 31 December 2023.

2.4 Repayment of government grants

A government grant may become repayable if the entity fails to comply with its conditions. Such repayment of a grant is accounted for as a **revision of an accounting estimate** in accordance with **LKAS 8.**

Repayment of a grant related to **income**	Apply first against any unamortised deferred income set up in respect of the grant; any excess should be recognised immediately as an expense. **Example**: if an entity must repay Rs. 2 million of a grant originally recognised as deferred income, and Rs. 1.2 million remains unamortised, the entity would eliminate the deferred income balance and recognise Rs. 800,000 as an immediate expense.
Repayment of a grant related to an **asset**	Increase the carrying amount of the asset or reduce the deferred income balance by the amount repayable. The cumulative additional depreciation that would have been recognised to date in the absence of the grant should be immediately recognised as an expense.

	Example: if an entity received a LKR 4,000,000 grant for machinery costing LKR 10,000,000, recorded at LKR 6,000,000. After 3 years, the carrying amount is LKR 4,200,000. On repayment of the grant, the carrying amount rises to LKR 8,200,000, and the extra amount is depreciated over the remaining 7 years. It is possible that the circumstances surrounding repayment may require a review of the asset value and an impairment of the new carrying amount of the asset.

Question 06 – Repayment of government grant

On 1 January 2017, ZZ Mining Co (ZMC) received a grant of Rs. 10 million from a government body for the purpose of operating in a given location over a 2-year period. 65% of the costs of operations were expected to be incurred in its first year. In February 2018, the government body realised that not all of the conditions stipulated in the grant documentation were met by ZMC, and asked for Rs. 5,500,000 to be refunded. ZMC repaid this in March 2018.

Required: Show the accounting entries required by ZMC in the years ended 31 December 2077 and 31 December 2018.

Question 07 – Repayment of a Grant Presented as Deferred Income

Lotus Construction received a Rs. 5,000,000 grants on 1 January 2022 for an asset with a 5-year life. The company uses the deferred income method. By 31 December 2023, Rs. 2,000,000 of the grants has been amortised to profit or loss (Rs. 1,000,000 per year for 2 years). On 1 January 2024, Lotus Construction fails to meet a condition and is required to repay the entire grant of Rs. 5,000,000.

Required: How should the above transaction be accounted for?

Question 08 – Repayment of a Grant Deducted from an Asset

BlueGem Textiles received a Rs. 2,000,000 grants on 1 January 2022 for a machine costing Rs. 10,000,000 with a 10-year life. The company uses the asset deduction method. On 1 January 2024 (two years later), BlueGem Textiles fails a condition and must repay the full grant.

Required: How should the above transaction be accounted for?

2.4 Government assistance

Some forms of government assistance cannot reasonably have a value placed on them. **Example:**

- free technical or marketing advice
- provision of guarantee

In addition, some transactions with government cannot be distinguished from the entity's normal trading transactions.

> **Example:** government procurement policy resulting in a portion of the entity's sales.

Disclosure of such assistance may be necessary because of its significance; its nature, extent and duration should be disclosed.

2.4 Disclosures

Transparency in financial reporting requires comprehensive disclosure of government grants to enable users to understand their nature, extent, and impact on the entity's financial position and performance. LKAS 20 mandates specific disclosures of the following:

a) Accounting policy adopted, including method of presentation
b) Nature and extent of government grants recognised and other forms of assistance received
c) Unfulfilled conditions and other contingencies attached to recognised government assistance