Don't take it for granted...

Accounting for government support may not be as simple as you first think

by Wayne Bartlett

The Covid-19 pandemic has had an enormous impact on a wide range of issues including accounting and reporting. Before Covid-19 arrived government support, whilst some organisations certainly benefitted from it, did not have quite the same universal significance as it now has.

Now out of the blue a very large number of businesses have suddenly found themselves in receipt of government support either in the form of loans at preferential rates or in terms of subsidies. This means that an issue that was perhaps not relevant to everyone has now become of more wide-ranging impact. In the process it has become much more important that accountants have a comprehensive understanding of how to account for such support so that the financial statements they prepare can be compliant with the reporting frameworks they use and reveal all the necessary details to readers of the accounts. The issue has suddenly become very mainstream.

Government support through the pandemic

In Ireland, support has come in various shapes and sizes. Some of this support has been in the form of loans. One particular model saw loans of up to €25,000 which included an interest-free period, with the Irish government rebating the interest that would normally be due. This particular scheme saw the government making the rebate once the full six-monthly repayments, including interest, had been made so to some extent this is retrospective in terms of its benefits. The loan is normally for a three-year term though there is a five-year alternative for capital expenditure by exception. Interest rates on this scheme vary between 4.5% and 5.5% depending on the body through which the application is made.

Guidance found in frameworks such as FRS 102 requires certain treatments to be adopted in the case of loans. If loans were to be made at below market rate, then paragraph 11.13 of FRS 102 requires that this should be accounted for as a financing transaction. However, it is accounting for grants that I think might have the greater impact on businesses generally and it is therefore these that I propose to focus on.

The Irish Government, in common with administrations in many other countries, has given a significant amount of support in terms of wage subsidies. The first of these schemes was known as the Temporary Wage Subsidy Scheme ("TWSS") and ran from 26th March to 31st August 2020. The scheme was operated by the Revenue Commissioners and in their view, TWSS payments are not payments to the employer and are not a grant. It will be interesting to see if this approach stands up to scrutiny. If this were the case, then the argument goes that it would not hit the Profit & Loss Account at all.

An alternative view is that these payments are grants and therefore should be dealt with in the Profit & Loss Account and should be recognised as other income rather than being netted off against expenditure. Interestingly a trawl through various articles relating to the treatment of wage subsidies in the UK resulted in a unanimous view amongst the sample of accounting firms analysed that they should indeed be treated as grants.

The glossary to FRS 102 describes a grant 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'. The various wage subsidy schemes that have been in place in Ireland come with a requirement that qualifying staff should be kept on the payroll and given this clear conditionality it seems to meet the glossary definition of a grant. So too, in my view, does the rebate of

interest paid by the government we discussed earlier.

The TWSS was replaced by the Employment Wage Subsidy Scheme ("EWSS") which ran from 1st September 2020. The pandemic has of course gone on for longer than expected or hoped for and so a replacement for the TWSS was needed. The EWSS is in effect a flat rate subsidy to employers in respect of qualifying employees on the payroll. The absolute amount of the subsidy paid by the government depends to some extent on the underlying pay rates of the employees who are being supported by this subsidy. This again is a scheme which emulates in the concept if not the absolute detail similar schemes adopted in other countries.

Accounting for grants per FRS 102 and FRS 105

Let's assume that the subsidies involved were to be treated as a grant. How does FRS 102 require such transactions to be dealt with? The guidance related to this is found in Section 24. This makes clear that the guidance does not apply to government assistance that is provided for an entity in the form of benefits that are available in determining taxable profit or loss or are determined or limited on the basis of income tax liability. Specifically excluded by the guidance are benefits such as income tax holidays, investment tax credits, accelerated depreciation allowances and reduced income tax rates. The subsidies given by the Revenue Commissioners clearly do not fall within these specific exemptions.

Two models of grant treatment apply per FRS 102. One is known as the performance model. Entities using this approach shall recognise income when grant proceeds are received or receivable if no specific performance-related conditions are attached by the grantor. If however, performance related conditions are attached to the grant then income should only be recognised when those conditions have actually been met.

The other is known as the accrual model. Under this approach grants relating to revenue should be recognised in income on what is termed a systematic basis over the period in which the entity recognises the related costs. In the case of wage subsidies, then this would mean that the income should be released to Profit & Loss Account in line with the wage expenditure that it is designed to support.

Note that the use of the performance or accrual model is at the discretion of the preparer of the financial statements. However, the same policy should be used for each class reported in the financial statements.

FRS 105 which focuses on SME reporting is similar in content though Section 19 which deals with grants is as one would expect a slimmed down version of FRS 102, Section 24. However, it is worth noting that it only allows the accruals model. Sub-section 19.8 of FRS 105 states that 'a government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognised as income in profit or loss in the period in which it becomes receivable.'

Disclosure is key

Assuming that the subsidies are treated as grants, the accounting treatment does not seem that complex. However, in order to fully understand the financial statements disclosures are often as important as the numbers included on the face of the financial statements themselves.

When we think about disclosures it is often as important to consider the underlying concepts and qualities of good accounting information as specific guidance from detailed elements of the financial reporting framework. It is certainly important in the case of disclosures that any unusual items which have a material impact are clearly explained in the financial statements.

The provision of large amounts of wage subsidy by the Irish government would certainly seem to fall within that general category. Whatever else these wage subsidies are, they are not routine. Therefore, for businesses which have taken advantage of the government support clearly

explaining its impact on the overall financial position is of paramount importance.

Disclosures are covered specifically by sub-sections 24.6 and 24.7 of FRS 102.Understandably, one of the things which must be disclosed is the accounting policy which has been adopted for the treatment of grants in the financial statements. So too should the nature and amounts of grants actually recognised in the financial statements. Any unfulfilled conditions and other contingencies attaching to grants should also be disclosed. If the transaction is not treated as a grant, then there is still a requirement to disclose it. Sub-section 24.6 (d) requires disclosure of any other form of government assistance from which the entity has directly benefited. Therefore, even if the ultimate decision is not to treat the wage subsidy as a grant, then full details of the government assistance must still be included in the financial statements.

Ensuring the underlying records are in good order is also important

The highly unusual nature of the government support given in the form of wage subsidies means that there is an inherent underlying risk of fraud. Investigations launched by the Revenue Commissioners into the use of TWSS subsidies have been very encouraging so far in this respect.

As reported in the Independent of 3 June 2021 only a small number of anomalies have been found, involving just 300 out of 66,500 businesses benefiting from the TWSS. Given the fact that some €2.9 billion has been given out this is extremely reassuring. It also compares remarkably favourably with support schemes in the UK where according to some estimates the Bounce Back Loan Scheme (BBLS) has potentially up to 50% of qualifying transactions which are suspect (though this includes amounts where default is a risk as well as fraud, so the comparison is not directly analogous). Nevertheless, the breath-taking amount at risk in the UK where the BBLS has doled out over £43 billion shows how important control of this highly material area is to governments involved in supporting such schemes.

That said, there is no room to be complacent in Ireland. Getting the accounting wrong could have extremely unfortunate consequences, both financial and reputational, for businesses falling foul of the Revenue Commissioners. It is therefore vital that adequate records are kept to support any expenditure claimed to qualify for the wage subsidies so that if the Revenue Commissioners were to undertake an audit they would be satisfied with the quality of the information that they find. Using grants or loans for inappropriate purposes can have unfortunate repercussions.

A few years ago, I was working in another European country when an EU grant amounting to some €10 million had not being spent for the purposes for which it had been awarded. The result of this breach, which may well have occurred because of ineffective controls rather than deliberate intent, was that the €10 million had to be returned. This is a situation best avoided for very obvious reasons so attention to detail and accuracy in record-keeping and reporting is vital.

Wayne Bartlett,
FCCA, MBA