

Accounting for nil- or low-interest loans from the government

Locally and internationally, governments are considering various methods of assisting organisations survive the tougher economic climate brought on by the 'credit crunch'. An example of one of the methods available to the government is the granting of a loan to an organisation at a nil- or low-interest rate. South Africa remains a relatively high interest rate environment and a nil- or low-interest loan may therefore be a popular method of assistance, as the recipient of the loan could enjoy a substantial interest saving.

Recipients of such loans need be aware of the revised reporting requirements issued by the International Accounting Standards Board (IASB) in respect of nil- or low-interest loans received from the government.

The previous treatment: a contradiction

Prior to the amendment of IAS 20 (AC 134), *Accounting for Government Grants and Disclosure of Government Assistance* in 2008, there was a contradiction in how such a loan from the government should be accounted for in terms of IAS 20 (AC 134) and IAS 39 (AC 133) *Financial Instruments Recognition and Measurement*.

IAS 20 (AC 134).37 stated that although loans, at a nil- or low-interest rate, are a form of government assistance (and therefore required narrative disclosure in the notes to the financial statements), the benefit would not be computed by the imputation of interest.

The journal entry upon initial recognition in terms of IAS 20 (AC 134), prior to current revisions, would therefore have been as follows:

	Dr R	Cr R
Bank	100 000	
Financial liability		100 000
<i>(Proceeds of loan from the government)</i>		

However, the actual loan from the government complied with the definition of a "financial liability" and thus the measurement rules of IAS 39 (AC 133) were applicable to the loan.

At initial recognition (when the proceeds of the loan were received) the loan would be measured at its fair value. In terms of IAS 39 (AC 133) the fair value for such a loan is determined by means of a "discounted cash flows" technique, whereby all future repayments (interest and capital) were discounted at the "market-related" interest rate. The fair value computed would be lower than the proceeds received and hence a difference would arise. This difference was classified as a "first-day gain" and immediately recognised as income. Subsequently, all interest-expenses recognised would be at a "market-related" interest rate computed according to the "effective interest method".

The journal entry upon initial recognition in terms of IAS 39 (AC 133) would therefore have been as follows:

	Dr R	Cr R
Bank	100 000	
Financial liability		90 000
First-day gain (Profit or loss)		10 000
<i>(Proceeds of loan from the government)</i>		

The revised treatment: correcting the contradiction

To resolve this contradiction, the IASB has revised the accounting treatment in respect of the benefit associated with the receipt of a nil- or low-interest loan from the government. The revision to IAS 20 (AC 134) prescribes that this "benefit" should now be accounted for as a government grant. The subsequent accounting policy for the government grant in terms of IAS 20 (AC 134) would then be dependent upon an assessment of the conditions attached to the loan.

Conditions require the acquisition of a long-term asset

If the loan agreement specifies that the proceeds of such loan should be used to purchase, or construct, a long-term asset, the benefit at initial recognition would be regarded as a *grant related to assets*. Consequently, the entity's accounting policy will be to account for this benefit as either deferred income or offset against the carrying amount of the asset. The deferred income would be recognised as an income in "profit or loss" on a systematic basis over the useful life of the asset that the entity purchased or constructed with the proceeds of the loan. Alternatively, if the benefit is offset against the carrying amount of the asset, the reduced carrying amount would result in a reduced depreciation expense.

The journal entry for the grant related to assets will be as follows at initial recognition:

	Dr R	Cr R
Bank	100 000	
Financial liability		90 000
Deferred income (SFP) / Property, plant and equipment		10 000
<i>(Proceeds of loan from the government)</i>		

(SFP = Statement of financial position)

No conditions to purchase or construct a long-term asset attached
If the loan agreement does not have a condition to acquire a long-term asset attached but rather other conditions, for example the loan is to fund research and development expenditure, the benefit would be regarded as a *grant related to income*. Accordingly, the



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benefit would initially be recognised as deferred income in the SFP position and subsequently recognised as income in "profit or loss" on a systematic basis over the periods in which the entity recognises, as expenses, the related costs for which the grant is intended to compensate.

The journal entry at initial recognition in terms of the revised IAS 20 (AC 134) will be as follows:

	Dr R	Cr R
Bank	100 000	
Financial liability		90 000
Deferred income (SFP)		10 000

(Proceeds of loan from the government)

Conclusion

An entity that receives a loan from the government at a nil- or low-interest rate would need to comply with the revised requirements

of IAS 20 (AC 134) from 1 January 2009. Interest would need to be imputed for such a loan and the resultant benefit would be accounted for as a government grant. Due to various complications that may occur with regard to existing loans from the government, the new treatment should be applied to all new loans and no retrospective adjustments need to be made to existing loans.

List of references

South African Institute of Chartered Accountants (2008). IAS 20 (AC 134) *Accounting for Government Grants and Disclosure of Government Assistance*. Kengray, Johannesburg: SAICA.

South African Institute of Chartered Accountants (2008). IAS 39 (AC 133). *Financial Instruments: Recognition and Measurement* Kengray, Johannesburg: SAICA. asa

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