In brief

A look at current financial reporting issues

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Accounting for government assistance in response to the COVID-19 pandemic

At a glance

This In brief considers the accounting implications of some of the measures introduced or planned to be introduced by the government to support businesses through the disruption caused by the COVID-19 pandemic. More information on the various measures can be found on PwC's website.

What is the issue?

The accounting for government grants and other forms of government assistance is set out in IAS 20 and, for UK GAAP reporters, Section 24 of FRS 102. Government grants are defined as "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" while government assistance is "action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria".

Government grants are recognised once there is reasonable assurance *both* that the entity will comply with any conditions *and* that the grant will be received. Reasonable assurance is not defined in IFRS or UK GAAP and significant judgment is therefore required in determining whether the recognition criteria have been satisfied. Some considerations might include:

- Are the measures currently available or do they merely represent policy statements/intentions?
- What are the steps required to apply/gain approval for the grant?
- Are the eligibility conditions satisfied?

In practice, entities often do not recognise grants until they are received or the entities have at least received confirmation of entitlement from the relevant government authority.

Both IFRS and UK GAAP require disclosure of the nature and extent of government grants recognised in the financial statements and an indication of any other forms of government assistance from which the entity has directly benefited. For IFRS reporters, IAS 20 sets out a further consideration of whether the significance of government assistance might be such that disclosure of its nature, extent and duration is necessary in order that the financial statements may not be misleading.

Some of the measures described below have tax consequences which are beyond the scope of this publication.

Coronavirus Job Retention Scheme

Under this scheme, HMRC will reimburse 80% of the wages of certain employees who have been asked to stop working ('furloughed'), but who are being kept on the payroll.

Accounting implications

As this scheme involves a transfer of resources from government to the entity, it meets the definition of a government grant. The scheme is designed to compensate for staff costs, so amounts received should be recognised in the income statement over the same period as the costs to which they relate. IFRS reporters may present the grant income separately in the income statement or net it off the related expense. UK GAAP reporters (and that includes FRS101 reporters) should present the grant income gross.

Statutory Sick Pay relief

Certain entities will be able to reclaim Statutory Sick Pay paid for up to two weeks' sickness absence due to COVID-19.

Accounting implications

The accounting implications are similar to the Coronavirus Job Retention Scheme described above (that is, amounts received should be recognised in the income statement over the same period as the costs to which they relate).

Business rates reliefs

There will be total relief from business rates for the tax year 2020/21 for certain entities operating in the retail, hospitality, leisure and nursery sectors.

In addition, certain entities in the retail, hospitality and leisure sectors or which pay little or no business rates might be eligible for one-off cash grants to help them to meet their ongoing business costs.

Accounting implications

There are no specific accounting implications where an entity is entitled to total relief from business rates for the tax year 2020/21. The charge will not be levied so there is simply no expense to recognise. There is no transfer of resources so the relief will not be a government grant, but it will represent a form of government assistance for disclosure purposes.

The cash grants clearly do meet the definition of government grants. Eligible entities do not need to satisfy any further performance or other conditions. Accordingly, the amounts received should be recognised in the income statement once the conditions for entitlement are satisfied and there is reasonable assurance that the grant will be received.

Deferral of VAT payments

UK VAT registered businesses that have a VAT payment due between 20 March 2020 and 30 June 2020 will have the option to defer the payment until 31 March 2021. Entities will still need to file their VAT return; however, HMRC will not charge interest or penalties on any amount deferred.

Accounting implications

VAT liabilities are not financial instruments as the rights and obligations arise from law, not contract. Therefore, our view is that there is no requirement to remeasure the amount for any kind of notional financing component (not least because the period of deferral is less than one year). The liability will often still be presented as current; however this will depend on the entity's year-end. Balances should be presented as non-current if the entity has the right to defer settlement more than one year from the balance sheet date.

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Coronavirus Business Interruption Loan Scheme

This scheme will give certain entities access to loans, overdrafts, invoice finance and asset finance. For entities satisfying certain size criteria, the government will cover the first 12 months of interest payments and any lender-levied fees.

The scheme will be provided through commercial lenders. The government will provide those lenders with a guarantee of 80% on each loan (although the borrowers remain liable for the full amount of the loans).

Accounting implications

Payments by the government to cover interest and other fees are government grants and so the accounting for these will be similar to the Coronavirus Job Retention Scheme described above. Each month, as an interest expense is recognised, an equal amount of interest credit will also be recognised in the same line in the P&L.

It is possible that there might be a second government grant in the form of the lower rate of interest than would likely have been payable in the absence of the government guarantee. (Indeed, in the absence of this scheme, eligible borrowers might not have had access to any form of bank finance.) In such a case, for IFRS reporters, the loan is recognised initially at fair value calculated using the prevailing market interest rate. UK GAAP reporters would measure the loan at the present value of the future payments discounted at a market rate of interest for a similar debt instrument. The government grant in each case is then measured as the difference between this initial carrying amount and the proceeds received. This government grant is recognised in the income statement in a similar way to the interest relief described above. One challenge with this accounting would be in determining what is a prevailing market interest rate for such a loan. It might be extremely difficult to make a reliable estimate. However, given that interest expense and the related grant credit could be recognised either in the same line or adjacently in the income statement, we believe it would be sufficient to disclose qualitatively that the government grant exists and stay silent on the quantitative split so as to avoid the operational burden of trying to determine what the current market interest rate for such an instrument without the benefit of the government guarantee might be.

COVID-19 Corporate Finance Facility

The COVID-19 Corporate Financing Facility will provide short-term funding to non-financial businesses by purchasing commercial paper. The aim is to support businesses which were fundamentally sound pre-COVID-19. It will be funded through the Bank of England to free up resources in the banking system for small and medium-sized entities (who rely the most on banks).

Accounting implications

The commercial paper will meet the definition of a financial liability and its issuance will be accounted for like any other issue of debt. However, similar to the Coronavirus Business Interruption Loan Scheme described above, the entity needs to consider whether the commercial paper has been issued at a market rate of interest. An important difference with this scheme is that it is only available to those entities that were previously considered to be financially sound, so there is no suggestion that the commercial paper might be issued at a rate other than market rate. Accordingly, in our view, there is likely no government grant to account for.

As noted above, a purpose of the scheme is to free up resources in the banking system for small and medium-sized entities. On this basis, it is reasonable to conclude that the scheme has a broader purpose with the beneficiaries being those entities to which banks might now lend, or even the banking system as a whole. Accordingly, from the perspective of participating entities, we believe this scheme does not represent “action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria” and so is not disclosable as government assistance. However, any disclosures required by IFRS 7 in respect of the commercial paper issued will need to be made.

Future Fund

The Fund will provide UK-based companies with between £125,000 and £5 million investment from the government, with private investors at least matching the government commitment. These loans will automatically convert into a variable number of shares on the company's next qualifying funding round. If not converted earlier, then at the maturity of the loan (expected to be no longer than 36 months) the holders have the option to choose: (i) for it to be repaid by the company with a redemption premium (being a premium equal to 100% of the principal of the bridge funding); or (ii) to convert into equity at the Discount Rate to the price set by the most recent funding round. The Conversion will be at a minimum conversion discount of 20% (the "Discount Rate") to the price set by that funding round, with a company repayment right in respect of the accrued interest. The Discount Rate will be higher if a higher rate is agreed between the company and the matched investors. In addition, interest will accrue annually at a rate that will be the higher of the rate agreed between the company and the matched investors, and an 8% minimum interest rate that is required by the Government.

Accounting implications

The matched funding, as regards both interest rates and conversion discount prices, indicates that the loans are being issued on an arms' length basis. Transaction price will therefore be considered fair value and hence there is no government grant to be recognised by the borrower. For IFRS purposes, these convertible loan notes are financial liabilities, and given the conversion feature is not into a fixed number of shares there is no equity component to split out. Rather there is an embedded derivative for the conversion option, which, if the borrower does not choose to measure the entire instrument at fair value, would have to be separated and measured at fair value separately from the host liability. For UK GAAP preparers, these convertible loans notes are complex financial instruments that also will have to be measured at fair value, with gains and losses recognised in the income statement.

Relaxation of rules on carrying over annual leave

Workers who have not taken all of their statutory annual leave entitlement due to COVID-19 will be able to carry up to four weeks over into the next two leave years.

Accounting implications

An additional right for workers to carry forward unused holiday does not represent a government grant. Nor would it be disclosable as a form of government assistance. Nevertheless there are accounting implications for some businesses.

Under both IFRS and UK GAAP, an entity should recognise the expected cost of accumulating compensated absences (such as holiday pay) when the employees render service that increases their entitlement to future compensated absences. Put simply, if an employee accrues 28 days paid holiday over the course of a year, the cost is recognised as that entitlement accrues. Often, businesses require a certain amount of holiday to be taken by employees each year. There is also an obligation on employers to ensure their workers take their statutory entitlement in any one year – failure to do so could result in a financial penalty. However, the new relief will mean that many more employees will be carrying forward unused holiday, which will in turn mean that many more entities will be required to carry forward a liability for unused holiday pay.

There are detailed worked examples for how to recognise and measure holiday pay in Chapter 12 of the Manual of Accounting: IFRS for the UK (the approach under UK GAAP would be similar).

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