1 Covid 19 issues – accounting for grants and loan schemes

1.1 Reminder – Accounting for grants under FRS 102 and FRS 105

FRS 102

Government grants are included in section 24, and the requirements are applied to all such grants with the exception of those which are available in determining taxable profits. These would include income tax holidays, investment tax credits, accelerated depreciation allowances and reduced income tax rates.

The glossary clarifies that government includes government agencies and similar bodies, whether local, national or international. This would include local authorities, which will be providing some of the financial assistance that is available to entities.

Transactions with the government which derive from the provision of goods and services which are normally provided by the entity are not included within the section. As a result of Covid 19, there may be some entities which have changed their operation to provide goods and services to the government for the first time. For example, some clothing manufacturers whose primary trade has been fashion clothing are now providing PPE items. These transactions would not fall to be treated as grants, even though the entity is now providing a product to a market which it has never supplied to before. These should be treated as normal trading.

A grant is defined as “assistance by government in the form of a transfer of resources to the entity in return for past or future compliance with specified conditions relating to the operating activities of the entity”. Operating activities are the principal revenue-producing activities and other activities which are not investing or financing activities.

Recognition

Grants are only recognised when there is reasonable assurance that:

- The entity will comply with the conditions
- The grants will be received

Accounting for grants

FRS 102 allows two models to be used:

- The performance model; the grant is recognised in line with the entity’s performance of the grant conditions
- The accruals model; the grant income is matched against the related costs for which the grant is intended to compensate.

Which model is chosen is an accounting policy choice, which should be disclosed, and applied on a consistent basis.

The model is only applied once the criteria above have been satisfied. Whichever model is chosen may affect recognition, i.e. the adoption of one model would require recognition whereas the application of the other would not. There will be instances where the recognition is not affected by whatever model is chosen.

The performance model

If the performance model is used, then there is a distinction between those grants that impose specified future performance-related conditions and those that do not. If there are no future performance-related conditions, then the grant is recognised when the grant proceeds are received or receivable. If there are, then the grant is recognised when the performance-related conditions are met. If the grant is received before the revenue recognition criteria are satisfied, then it is recognised as a liability.

The accruals model

Under the accruals model, the grant is matched against the expenditure that it is expected to compensate for. It is recognised in profit and loss over the relevant period. If it is unclear as to what expenditure it is compensating for, then a decision will need to be made as to whether it is a grant relating to revenue or one relating to assets. If revenue, it should be recognised on a systematic basis over the period the related costs are recognised. If the compensation is for expenses or losses already incurred, or for immediate financial support where there will not be any future related costs, then it is recognised when receivable.

Covid 19 considerations

Grants associated with Covid 19 will be in respect of conditions that existed at a point in time in the past. Therefore, whether there has been compliance will be a matter of fact. For some entities receipt maybe after the period end. For example, many of the grants were payable from 1 March 2020, but receipt may have been some time later. The 31 March is the most popular period end in the UK, and therefore, there will be entities who are entitled to a grant for March, but this is received sometime after the period end.

There will be a similar situation for 31 December 2020 period ends. Under the CJRS scheme entities who furloughed employees and these individuals are still employed for November, December, and January they will receive a payment of £1,000 per individual. Whether this applies to an entity will require full consideration of the requirements. This raises the question as to whether an entity with 31 December period end should accrue 2/3rds of the bonus on the basis they expect to satisfy the conditions to receive it in February/March.

There have also been questions about the recognition of grants received from local authorities in March/April as to whether these should be recognised at 31 March if received before this date. It has been suggested that if the accruals model is applied, then the income should be deferred to the next period on the basis it is to meet future expenditure. However, it is also noted that these grants were paid to provide general financial support and to meet costs in the future. However, there were no specific costs, and on this basis, it could be suggested that grants should be recognised when received or receivable.

The ICAEW TAS guidance issued May 2020, and the ACCA guidance issued October 2020, conclude as follows.

Under the performance model, a grant that does not impose specified future performance-related conditions on the recipient is recognised when the grant proceeds are received or receivable. Where there was certainty that the grant would be received, this would be when the scheme eligibility criteria were first published. The guidance issued by the government to local authorities stated the entitlement date for eligible recipients was the earlier of the payment of the grant by the local authority, or 1st April 2020. It should be noted that the eligibility date of the scheme was 11 March 2020, as stated in the same document. Hence, if the reasonable assurance requirements were met, the grant should be recognised at 11 March. However, if there was uncertainty around eligibility, the reasonable assurance test would not have been satisfied, and it would be recognised when confirmation of entitlement was received from the local authority. If not received in the period it should be shown as income with a corresponding debtor.

Under the accrual model FRS 102 24E states that where the grant compensates for expenses or losses already incurred or for giving immediate financial support with no future related costs, it is recognised when receivable. As regards the first aspect there may have been some costs incurred to a 31 March period end, but these would have been minimal. Hence it could be argued that the grant should be accrued to the next period. However, the grant was not in respect of any specific costs, which creates difficulties in trying to match the grant to those costs. In respect of the later, it has been argued that this does not apply as there were future related costs. Again, the question is what future related costs; the grant is not identifiable to any cost. The ICAEW TAS concludes on the same basis as above. Where there is certainty as of the date, the scheme eligibility criteria were first published. If there was uncertainty when confirmation of entitlement was received from the local authority.

Disclosure - FRS 102

The following require disclosure:

- The accounting policy adopted
- The nature and amounts of grants recognised in the financial statements
- Unfulfilled conditions or contingencies
- Indication of other forms of government assistance from which the entity has directly benefitted

FRS 102 section 1A entities would need to disclose the accounting policy and the nature of any contingencies. There is no requirement to disclose the nature and amounts, or other forms of assistance received.

Many entities, who have never received grants in the past, will be in receipt as a result of Covid 19. The Regulations, FRS 102, and FRS 105 require the disclosure accounting policies used to determine items shown in the balance sheet/SoFP and profit and loss/IS. Preparers of financial statements will need to ensure policies are included as required.

FRS 105

FRS 105 only allows the accruals model.

1.2 Small business grants

There are three categories small business grants:

- Small business grant fund
  - ➢ A one-off grant of £10,000.
  - ➢ Business must be based in England, occupy property and eligible for small business rate relief.
  - ➢ No claim required, the local council will determine and contact, if not application can be made
- Retail, hospitality and leisure grant fund
  - ➢ One-off cash grant £10,000 or £25,000.
  - ➢ Business must be based in England, in the retail, hospitality or leisure sector and have a ratable value under £51,000 on 11/03/2020.
  - ➢ No claim required, the local council will determine and contact, if not application can be made
- Local authority discretionary grant fund
  - ➢ Cannot be eligible for either of the above.
  - ➢ Grant of £25,000, £10,000 or any amount under £10,000.
  - ➢ Must be based in England with high on-going property costs.
  - ➢ Property with a rateable value or rent/mortgage payments below £51,000.
  - ➢ Trading on 11 March 2020.
  - ➢ Need to show a significant fall in income due to Covid 19

Are these grants under GAAP?

The definition of a government grant is

"assistance by government in the form of a transfer of resources to the entity in return for past or future compliance with specified conditions relating to the operating activities of the entity."

There have been some comments that these payments do not meet the above definition, on the basis, there are no conditions, except for being in a particular sector. The ICAEW in their guidance of May 2020 state that all of the above are grants with no further performance conditions to be satisfied.

Presentation

If an entity has a 31 March period end and the grant is received before this date, should it be recognised, or deferred to the following period.

See comments above

How should it be presented in profit and loss?

Under the Regulations:

- FRS 105 entities it would be included as "Other income". There is no obligation to disclose the nature of the income.
- FRS 102 entities could refer to it specifically, or as "Other operating income". There is no statutory requirement to disclose further information by way of note, but this may be required to show a true and fair view.

Does it make any difference as to whether they are grants or not?

It is likely that most of the entities in receipt of these payments will report under section 1A. If this is the case, then the detailed disclosure requirements of section 24 do not apply. However, an accounting policy should be disclosed, and this should refer to which model has been adopted. Recognition would be on the basis of received or receivable.

If the entity has adopted FRS 105 then no disclosure is required.

If section 1A has not been adopted then the disclosure requirements are:

- The accounting policy adopted for grants in accordance with paragraph 24.4;
- The nature and amounts of grants recognised in the financial statements;
- Unfulfilled conditions and other contingencies attaching to grants that have been recognised in income
- An indication of other forms of government assistance from which the entity has directly benefited.

1.3 CJRS

This falls within the definition of a grant under FRS 105, FRS 102 (and IAS 20).

The grant should be recognised where there is reasonable assurance (applied to both aspects) that the entity satisfies the criteria, and the grant will be received. Reasonable assurance is not defined; therefore, significant judgment will be required.

There will be an issue for entities with 31 March period ends. The requirements are known, and the submission system requires specific information and includes certain checks. On this basis, it is suggested that it is receivable and should be matched to the related expenditure. However, this may be seen as the application of the accruals model rather than the performance model. As noted above, the application of the accruals or the performance model is a matter of accounting policy choice. Entities applying FRS 105 must apply the accruals model.

Under IAS 20 there is no separate recognition of two models. Grants are recognised as either in profit and loss or outside profit and loss. The former applies to assistance for expenses, the later for asset-based grants. If the grant is in respect of expenses and costs, then it is recognised on a systematic basis over the period they are recognised, i.e. matched. If they are for expenses or losses already incurred, the grant is recognised in the period it is receivable.

An issue with the CJRS is that some employers will continue to pay furloughed employees, either 80% of their salary, or in full. Other employers will await the grant from the government and then pay the employees either the grant value or with a top-up. Therefore, there will be a variety of scenarios.

Consideration should also be given as to whether there is a contingent liability at the period end. The employer performs the calculations and errors may be made. Where employees are on "flat salaries" the calculation will be straight forward, and there may not be any exposure to repayment. Where employees are on zero-hour contracts, or where the salary varies, e.g. hourly paid. There is a risk there will be errors, particularly as some of the requirements are open to interpretation. For example, the guidance states you can claim for "regular payments", but this term is not fully defined. It states that compulsory commission payments are included, but discretionary payments for commission and bonuses are not.

Can the grant be netted against the expense?

Entities using IAS 20 can either net the grant receipt against the cost or include as income. Entities using FRS 102 and FRS 105 should show the grant receipt gross. This is because the Regulations do not permit income and expenses to be off-set (on the same basis that assets and liabilities cannot be off-set unless there is a legal right of set-off).

1.4 Coronavirus Business Interruption Loan Scheme (CBILS)(CLBIS)

Entities which have adopted FRS 105 are required to allocate the interest expense at a constant rate on the carrying amount. There is no requirement to consider whether there is a market rate of interest.

Accounting for CBILS

The ICAEW TAS published guidance on accounting for Covid 19 issues in May 2020. To consider the accounting for these loans, we need to consider the requirements of FRS 102.

Example

An entity borrows £100,000 over a five year period at an interest rate of 5%. Period end 31 March, loan taken out 1 April 2020. Assume no upfront fees and loan and interest repaid over the period in equal instalments at the end of each period.

Loan	100,000		Interest	5%	
Period	5		PMT	23,097	
Period to	**B/fwd/Rec'd**	**Interest**	**Paid**	**C/fwd**	
31/03/2021	100,000	5,000	23,097	81,903	
31/03/2022	81,903	4,095	23,097	62,901	
31/03/2023	62,901	3,145	23,097	42,949	
31/03/2024	42,949	2,147	23,097	21,999	
31/03/2025	21,999	1,100	23,097	2	
		15,488	115,485		

If the above was a CBILS, then the first-year interest is paid by the government. How does this affect accounting? There appear to be two views. The first has two options depending on whether the loan agreement is between two parties (entity and financial institution) or three (entity, financial institution and government). The other view is that as the government has met the first-year interest payment, the interest paid by the entity is below market rate. This is a financing transaction under FRS 102 11.13, and the liability should be shown at present value.

If the agreement is between the bank and the financial institution, then the borrower is liable for all the interest, but the government meets the first year. Using the above example, the payment in year one is reduced; on the basis, the government pays the interest.

Loan	100,000		Interest	5%	
Period	5				
Period to	**B/fwd/Rec'd**	**Interest**	**Paid**	**C/fwd**	
31/03/2021	100,000		18,097	81,903	
31/03/2022	81,903	4,095	23,097	62,901	
31/03/2023	62,901	3,145	23,097	42,949	
31/03/2024	42,949	2,147	23,097	22,000	
31/03/2025	22,000	1,100	23,097	3	
		10,488	110,485		

To record the government grant, a journal could be raised: Dr Interest £5,000, Cr Government grant £5,000.

The ICAEW TAS are of the view that the loan is a financing transaction as there is no interest accruing in year one and the interest charge is, therefore, less than 5%.

The comparison is as follows:

Calculations would be:

Value of government grant				5,000			
Present value at interest rate for one year				4,762			
PMT				21,998			
Loan	100,000		Interest	5%			
Period	5						
Period to	**B/fwd/Rec'd**	**PV adjust**	**CV of loan**	**Interest**	**Paid**	**C/fwd**	
31/03/2021	100,000	4,762	95,238	4,762	21,998	78,002	
31/03/2022	78,002			3,900	21,998	59,905	
31/03/2023	59,905			2,995	21,998	40,903	
31/03/2024	40,903			2,045	21,998	20,950	
31/03/2025	20,950			1,048	21,998	0	
				14,750	109,988		
Interest - net				9,988			

Initial accounting entries:

Dr Cash £100,000

Cr Loan £95,238

Cr P&L £4,762

At the end of year 1

Dr Interest £4,762

Cr Loan £4,762

1.4.1 Business Bounce Back Loan Scheme

Applications to this scheme could be made from early May. The maximum loan is £50,000, minimum £2,000. The maximum loan is 25% of turnover. Application is made electronically to various lenders, and they do not have to assess affordability and viability. Repayment is over six years, and interest is fixed at 2.5% per annum. The government will cover the first year interest and any charges. The loan is backed by a 100% guarantee from the government. No repayments are required in the first 12 months, but interest and principal have to be repaid over the remaining term.

Accounting for BBLS

Accounting would be as per CBILS above, except there is no payment of principal required in the first year.

Example

An entity borrows £50,000 over a five year period at an interest rate of 2.5%. Period end 31 March 2020, loan taken out 1 April 2020. Assume no upfront fees and loan and interest repaid in year 2 to 4, at the end of each period.

Loan	50,000		Interest	2.5%		
Period	5					
Period to	**B/fwd/Rec'd**	**Interest**	**Paid**	**C/fwd**		
31/03/2021	50,000	1,250	10,762	40,488		
31/03/2022	40,488	1,012	10,762	30,738		
31/03/2023	30,738	768	10,762	20,745		
31/03/2024	20,745	519	10,762	10,501		
31/03/2025	10,501	263	10,762	2		
		3,812	53,810			

If the above was a BBLS, then the first-year interest is paid by the government, and no payment of principal is required.

How does this affect accounting? As above there will be two views. The first has two options depending on whether the loan agreement is between two parties (entity and financial institution) or three (entity, financial institution and government). The other view is that as the government has met the first-year interest payment, the interest paid by the entity is below market rate. This is a financing transaction under FRS 102 11.13, and the liability should be shown at present value.

If the agreement is between the bank and the financial institution, then the borrower is liable for all the interest, but the government meets the first year. Using the above example, the payment in year one is reduced; on the basis, the government pays the interest.

Loan	50,000		Interest	2.5%		
Period	5					
Period to	**B/fwd/Rec'd**	**Interest**	**Paid**	**C/fwd**		
31/03/2021	50,000			50,000		
31/03/2022	50,000	1,250	13,290	37,960		
31/03/2023	37,960	949	13,290	25,619		
31/03/2024	25,619	640	13,290	12,969		
31/03/2025	12,969	324	13,290	4		
		3,164	53,160			

To record the government grant a journal could be raised: Dr Interest £1,250, Cr Government grant £1,250.

The ICAEW TAS considerations above would also apply.

2 Covid 19 issues – accounting for rent holidays

Example

As a result of Covid 19, a landlord agrees to a rent holiday for three months.

2.1.1 FRS 102

At the present time, there is no guidance from the FRC. Property leases are likely to be operating leases for both the lessor and lessee.

The above example does not give rise to a lease incentive; because it is not being provided by the lessor to enter into a new lease or to renew an existing lease. FRS 102 requires the recognition of an expense over the lease term on a straight-line basis unless another systematic basis is representative.

There are two schools of thought. The charge to profit and loss should be as per the arrangement; i.e. no lease expense and then increased payments in the future. Alternatively, the rent charge is included and an amount carried forward to represent the increase at some time in the future. It is also noted that in many instances the entity was unable to use the facilities, and hence they did not receive economic benefits from its use.

The same applies to lessors.

In July 2020 the FRC released FRED 76 which addresses this issue. This proposes the following:

- Any change in lease payments arising from rent concessions that meet the conditions over the periods that the change in lease payments is intended to compensate
- The conditions are:
    - Rent concessions must be as a direct consequence of COVID-19 pandemic and all of the following must be met:
    - Revised consideration is less than immediately preceding the change
    - Reduction only affects payments originally due on or before 30 June 2021
    - There are no significant changes to other terms and conditions of the lease
- The changes recognised above should be disclosed. Therefore, disclosure for operating leases will be the total of future minimum lease payments under non-cancellable operating
- Not later than one year;
    - Later than one year and not later than five years
    - Later than five years
    - Lease payments recognised as an expense
    - Changes in lease payments recognised above

For lessors, they recognise any change in lease income that meet the same criteria over the periods that the change in lease payments is intended to compensate.

3 Covid 19 and Going concern

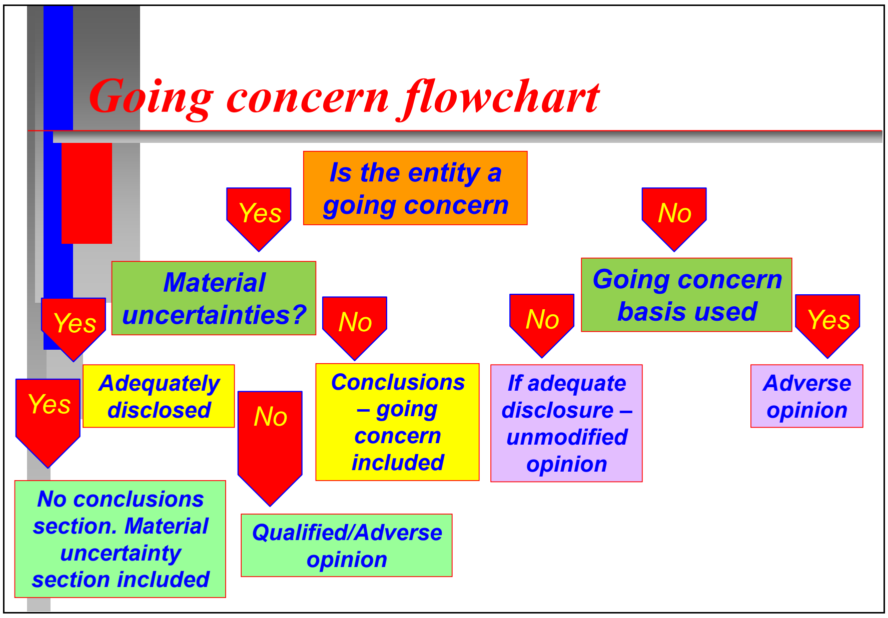
There needs to be a consideration as to whether the impact of Covid 19 gives rise to a material uncertainty which casts a significant doubt over the entity's ability to continue as a going concern. There are certain sectors where the impact will be significant and would require disclosure. This would also require the auditor to consider this when preparing their report. I have had questions from auditors in respect of this when the client has asserted that there is no significant doubt. Other auditors have considered disclosures in respect of Covid 19 and going concern to be required for all reports signed from March and onwards. There is no hard and fast rule. Some entities may have the cash resources, without the need to resort to financial support from the government, to ride out the pandemic. Others may consider that the nature of the business is such that Covid 19 has no effect or may increase the activity over a short period of time. The problem is that no-one is too sure how long it will last and what the outcome will be for businesses.

For directors, the requirement is to consider whether there are any significant doubts that create a material uncertainty. This would require an analysis of the business finances, the operation, the effect on suppliers, and the effect on customers. The period considered should be at least 12 months from the date on which the financial statements are approved for issue.

For auditors, the requirement is to consider the evidence prepared by the directors and to conclude whether or not there is a significant doubt giving rise to a material uncertainty. If disclosures are made in the financial statements, then these would be referred to in the audit report. The ICAEW AAF have published Guides in respect of this. Where the entity is audit exempt there is no requirement for the accountant to review any evidence as regards going concern. However, there is a requirement for ICAEW and ACCA members to comply with ther Fundemental Principles. For ICAEW members, in Tech 07/16, the following is included:

> Members shall not, therefore, knowingly be associated with financial information where the professional accountant believes that the information:
>
> •Contains a materially false or misleading statement;
>
> •Contains statements or information furnished recklessly; or
>
> •Omits obscures information required to be included where such omission or obscurity would be misleading.
>
> When a professional accountant becomes aware that the accountant has been associated with such information, the accountant shall take steps to be disassociated from that information.

The following flowchart, mainly applicable to auditors, highlights the considerations.


Going concern flowchart
Is the entity a going concern
Yes
No
Material uncertainties?
Going concern basis used
Yes
No
No
Yes
Yes
Adequately disclosed
No
Conclusions – going concern included
If adequate disclosure – unmodified opinion
Adverse opinion
No conclusions section. Material uncertainty section included
Qualified/Adverse opinion

4 Covid 19 and conditions which existed at the balance sheet date

The requirement in FRS 102 is that the balance sheet reflects conditions that existed at that date. Events arising after that date are considered in two categories:

- Those which provide further evidence of conditions existing at the period end; adjusting events.
- Those which are indicative of events which arose after the period end; non-adjusting events.

One issue will be trying to recall sometime after the period what the conditions were at the period end as compared to what occurred after the period end and were not indicative of conditions at the period end. Therefore the timeline of events will be important.

The second most popular period end in the UK is 31 December. At this date, the emergence of the coronavirus is a non-adjusting event. For 31 March period ends the pandemic has been declared, the “lockdown” is in place, and the pandemic is an adjusting event. There will need to be careful consideration for 21 January and 29 February period ends.

For 31 December period ends the measurement of assets and liabilities should not be adjusted for the impact of Covid 19. Any estimates of cash flows will need to be based on what was reasonably known at the period end and not influenced by what has happened after. For example, the NRV of inventory may have fallen as a result of Covid 19. For some entities, the inventory may have to be scrapped as it cannot be sold in the current environment. The value of the inventory is not impaired at the period end, and no provision can be made. Convincing directors of OMBs of this may be a challenge. This may also impact the tax position. The same will need to be applied to trade debtors; there is likely to be an increased in the impairment of trade debtors aa many businesses will not survive the pandemic. Considering this some months after the period end will be a challenge.

The only exception to the above is if the entity is no longer considered to be a going concern. Going concern requires consideration of events after the period end, which indicate the entity will cease trading or have no realistic alternative but to do so.

The same would apply to assets held at fair value, e.g. investment portfolio. The global impact on the stock markets occurred towards the end of February and therefore entities with 31 December and 31 January period ends would have seen the value of the portfolios reduce considerably. This fall in fair value is a non-adjusting event.

For some entities, there may be an impairment of assets, not including inventory and trade debtors. FRS 102 requires consideration at the cash-generating unit level. Determining the fair value, less cost to sell, would be at the period end, not as a result of events which occurred after that date. Value in use is the present value of future cash flows; which again would be based on the circumstances at the period end.

It is likely that all business will need to include disclosure as to the impact of Covid 19. While FRS 102 does not set any benchmarks for which non-adjusting events are disclosed, it is likely to be required to show a true and fair view.

This will require consideration throughout the Covid 19 period, which could be months. For example, an entity with 31 March period end should consider the events that existed at that date and not when the financial statements are prepared some months later. The stages of recovery may not be known at the period end.