

**PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)  
QUESTIONS AND ANSWERS (Q&As)**

**Q&A No. 2007-02**

**PAS 20.24, 20.37 and PAS 39.43 – Accounting for government loans with low interest rates**

**Background**

Government loans with low interest rate are sometimes provided to certain banks as government financial assistance, the proceeds of which are to be invested by the recipient bank in government securities at prevailing interest rates.

Two standards apparently provide conflicting accounting guidance for loans with low interest rates. These are PAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, and PAS 39, *Financial Instruments: Recognition and Measurement*.

Paragraph 37 of PAS 20 states that loans at nil or low interest rates are forms of government assistance, but the benefit is not quantified by the imputation of interest. Under PAS 20, the loan is recognized initially at the nominal amount of the loan and is not subsequently measured at fair value. No fair value gain or loss is recognized. The nature, extent and duration of the assistance are, however, disclosed.

Under paragraph 43 of PAS 39, on the other hand, a government loan with low interest rate is a financial liability which is required to be measured initially at the fair value of the loan (i.e., the present value of all future cash payments discounted using a market rate of interest). Under paragraph AG64 of PAS 39, the difference between the fair value at initial recognition and the loan proceeds received is recognized in income.

The Bangko Sentral ng Pilipinas supports the measurement of the government loan at initial recognition at fair, consistent with PAS 39. It, however, considers the difference between the fair value at initial recognition and the loan proceeds received as a government grant to be recognized in income over the life of the loan, consistent with the accounting for government grants under PAS 20.

The International Accounting Standards Board (IASB) has recognized the conflict between IAS 20 and IAS 39, the basis for PAS 20 and PAS 39, respectively, at its July 2004 meeting. IAS 20 explains that loans at nil or low interest rates are forms of government assistance, but the benefit of the reduced loan is not treated as a government grant. The IASB noted that these requirements conflict with the IAS 39 requirement to measure financial liabilities initially at fair value. The IASB, therefore, decided to delete the references to loans at nil or low interest rates and guarantees from IAS 20. At its February 2006 meeting, the IASB acknowledged that IAS 20 is inconsistent with the *Framework for the Preparation and Presentation of Financial Statements*. However, IASB decided to defer the work on IAS 20 until further work on other projects are completed. To-date, issues relating to IAS 20 have not yet been resolved.

**Issues**

1. Should a government loan with low interest rate be initially recognized (a) at the nominal value of the loan, or (b) at fair value?

2. If the government loan is initially recognized at fair value, should the difference between the fair value at initial recognition and the loan proceeds be recognized (a) immediately in income, or (b) on a systematic basis over the life of the loan?

### **Consensus**

Because of the conflict in existing accounting guidance on loans with low interest provided in PAS 20 and PAS 39, the three following alternatives are considered acceptable. The alternative adopted shall be consistently applied.

#### **View 1**

PAS 20 is followed because it is the more specific standard relating to government assistance and is still in effect (i.e., it has not yet been amended or superseded).

Under PAS 20, the government loan is recognized initially at the nominal amount of the loan and is not subsequently measured at fair value. No fair value gain or loss is recognized.

#### **View 2**

PAS 39 is followed because it is the more recent standard. In addition, PAS 39 does not scope out government loans with low interest rates, and these are thus measured initially in the same manner as low interest loans from any other creditor.

Under PAS 39, a government loan with low interest rate is a financial liability which is measured initially at fair value (i.e., the present value of all future cash payments discounted using a market rate of interest). The difference between the fair value at initial recognition and the loan proceeds received is recognized in income.

#### **View 3**

A government loan, which is a financial liability, is measured initially at fair value (i.e., the present value of all future cash payments discounted using a market rate of interest) under PAS 39. The difference between the fair value of the loan and the proceeds of the loan are considered a form of government grant under PAS 20, recognized as income on a systematic basis over the period of the loan.

### **Effective Date**

The consensus in this Q&A is effective from April 19, 2007, the date of approval by the FRSC. Earlier application is encouraged.

### **Transition**

A change in accounting policy shall be accounted for in accordance with the requirements of PAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Date approved by PIC: February 21, 2007

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Date approved by FRSC: April 19, 2007