STAFF PAPER

March 2016

IFRS Interpretations Committee Meeting

Project	**IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance***
Paper topic	Accounting for recoverable cash payments

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Introduction

1. The IFRS Interpretations Committee (the 'Interpretations Committee') received a request to clarify how an entity should account for a cash payment received from a government to help the entity finance its research and development project (hereafter referred to as the 'R&D project').

2. The submitter described a transaction in which:

   (a) the government makes a cash payment to an entity during the research phase of a project. The amount of the payment is calculated as a percentage (for example, 60 per cent) of research expenses incurred (hereafter referred to as 'the cash payment').

   (b) at the end of the research phase of the R&D project, if the entity decides not to exploit and commercialise the results from this phase (ie it decides to abandon the project), it does not have to refund the cash payment. Instead, in this case, the entity must transfer the rights attached to the R&D project to the government.

   (c) if the entity decides to exploit and commercialise the results from the research phase of the R&D project, it must repay the cash payment. A portion of the repayment is fixed and is payable over a specified number of years, while another portion is based on a percentage of revenue generated from the commercialisation of the research results.

(d) in cases in which the entity starts exploiting the results but subsequently decides to abandon the R&D project, the entity is exempt from future repayments (but does not receive a refund relating to past repayments), provided that some conditions are met (e.g. formal notification to the government explaining that the decision is based on rational grounds such as a negative development in the economic, technological or legal environment). In such cases, the entity must transfer the rights attached to the R&D project to the government.

(e) in typical scenarios, the cash amount repayable can range from a minimum of 50 per cent (in cases in which the entity exploits the results but the project is not successful or is later abandoned) to a maximum of 200 per cent of the cash payment (in cases in which the project is successful).

3. The submitter questioned whether the entity should account for the cash payment as a liability when received (on the basis that it is a forgivable loan as defined in IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*) or in profit or loss when received (on the basis that it is a government grant as defined in IAS 20).

4. The Interpretations Committee discussed this submission at its meeting in November 2015[1]. The Interpretations Committee noted that the entity had obtained financing for its R&D project and the accounting would depend on the specific terms and conditions of the cash payment received. The Interpretations Committee observed that the arrangement described in the submission is a financial liability within the scope of IFRS 9 *Financial Instruments*. Many members of the Interpretations Committee thought that the arrangement also meets the definition of a forgivable loan as defined in IAS 20. The Interpretations Committee observed that judgement would be required in making this assessment and in determining when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan.

[1] Further information on the background of the submission and staff analysis presented at the Interpretations Committee's meeting in November 2015 can be found in Agenda Paper 7 for that meeting.

5. The Interpretations Committee noted that the requirements in IFRS Standards provide an adequate basis for an entity to determine the accounting for the cash payment received from a government. The Interpretations Committee observed that diversity in practice appeared to be limited on the basis of the feedback it had received from its outreach activities.

6. In the light of existing requirements in IFRS Standards and the feedback received from its outreach activities, the Interpretations Committee determined that neither an Interpretation nor an amendment to a Standard was necessary. The Interpretations Committee, therefore, decided to issue a tentative agenda decision outlining its reasons for not adding the issue to its agenda.

7. The purpose of this paper is to provide the Interpretations Committee with an analysis of the comments received on the tentative agenda decision and to ask the Interpretations Committee if it agrees with the staff recommendation to finalise the agenda decision.

Comment letter summary

8. We received five comment letters, which have been reproduced in Appendix B to this agenda paper.[2]

9. One respondent (Mazars) agrees with the Interpretations Committee's decision not to add this issue to its agenda for the reasons outlined in the tentative agenda decision.

10. Three respondents (Deloitte, PwC and ESMA) also agree with the Interpretations Committee's decision not to add this issue to its agenda. However, these respondents asked the Interpretations Committee to clarify some aspects of the agenda decision and have also provided some drafting suggestions.

11. One respondent (Accounting Standards Committee of Germany) disagrees with the conclusions reached by the Interpretations Committee. In particular, the respondent disagrees with the conclusion that the cash payment is a financial liability. The

[2] The comment letter received from Mazars included comments on several tentative agenda decisions published in the *IFRIC Update* from November 2015. In Appendix B, we have included only the excerpt from the letter that is relevant to this tentative agenda decision.

respondent thinks that the entity does not have an obligation to deliver cash, because fulfilling the conditions for repayment is at the discretion of the entity. Therefore, the respondent is not convinced that the rationale in the agenda decision is appropriate. The respondent thinks that the cash payment would have to meet the definition of a forgivable loan in IAS 20 in order to be recognised as a financial liability.

12. PwC has suggested that the Interpretations Committee should, in the wording of the final agenda decision:

(a) include the basis for its conclusion that the cash payment is a financial liability;

(b) explain that the cash payment could meet the definition of both a forgivable loan and a financial liability. PwC thinks that the wording of the tentative agenda decision implies that it is necessary for an entity to first assess whether the cash payment meets the definition of a financial liability before considering the guidance in IAS 20 to determine whether it is also a forgivable loan; and

(c) remove the reference to limited diversity in practice. PwC states that it has observed diversity in practice in accounting for cash payments similar to those described in the agenda decision. PwC has also noted that there are many different types of arrangements, which may have different structures and objectives that could give rise to different accounting treatments.

13. Deloitte agrees with the conclusions of the Interpretations Committee that the cash payment described is a financial liability and that judgement is required in determining whether the definitions in IAS 20 are met. However, Deloitte does not think that the statement ‘many members of the Interpretations Committee thought that the arrangement also met the definition of a forgivable loan’ is helpful. They think that the agenda decision should only include statements on which the Interpretations Committee as a whole can reach a consensus.

14. ESMA, who is the original submitter of this issue, agrees that the cash payment described gives rise to a financial liability. However, ESMA thinks that the Interpretations Committee should clarify whether an entity takes into account the forgivable character of the cash payment when determining its fair value.

15. We have analysed the concerns raised by the respondents in the following section.

Staff analysis

Is the arrangement described in the submission a financial liability?

16. We think that the cash payment meets the definition of a financial liability.

17. Paragraph 20 of IAS 32 *Financial Instruments: Presentation* states that (*emphasis added*):

> A financial instrument that does not explicitly establish a contractual obligation to deliver cash or another financial asset may establish an obligation indirectly through its terms and conditions. For example:
>
> (a) a financial instrument may contain a non-financial obligation that must be settled if, and only if, the entity fails to make distributions or to redeem the instrument. *If the entity can avoid a transfer of cash or another financial asset only by settling the non-financial obligation, the financial instrument is a financial liability.*
>
> (b)…..

18. We agree that the entity may have the discretion to abandon the R&D project and avoid a transfer of cash to the government. However, in that case, the entity has an obligation to transfer the rights attached to the R&D project to the government (ie settle a non-financial obligation). Accordingly, we think that the arrangement meets the definition of a financial liability.

19. We agree with PwC's suggestion to include in the final agenda decision the basis for the conclusion that the cash payment meets the definition of a financial liability. We have revised the proposed wording for the agenda decision (as outlined in Appendix A).

Determining fair value of the cash payment at initial recognition

20. ESMA agrees that the arrangement described gives rise to a financial liability. However, ESMA thinks that the Interpretations Committee should clarify whether an entity takes into account the forgivable character of the cash payment when determining the fair value of the cash payment at initial recognition. ESMA notes that the favourability in many of the arrangements is primarily related to the fact that the cash payments are forgivable, while the interest rate charged is a market rate for a non-forgivable loan that is otherwise similar. ESMA has concerns that the interplay between paragraphs 10 and 10A of IAS 20 is not entirely clear.

21. We think the issue raised by ESMA relates to how an entity measures the financial liability at initial recognition. We note that paragraph 5.1.1 of IFRS 9 requires an entity to measure financial liabilities at fair value at initial recognition. IFRS 13 *Fair Value Measurement* contains the principles and requirements for measuring the fair value of a financial liability. We think that the principles and requirements within IFRS 13 provide an adequate basis to enable an entity to make a determination of the fair value of the financial liability.

22. We have amended the proposed wording of the agenda decision as outlined in Appendix A to clarify that the entity accounts for this financial liability applying IFRS 9 (IAS 39 *Financial Instruments: Recognition and Measurement*).

Other comments

23. Deloitte suggests removing the statement 'many members of the Interpretations Committee thought that the arrangement also met the definition of a forgivable loan'. We agree with the respondent's suggestion and rationale and have revised the proposed wording for the agenda decision as outlined in Appendix A to this paper.

24. We think this revision also addresses the concern raised by PwC that the wording of the tentative agenda decision could be read as implying that an entity should first assess whether the cash payment meets the definition of a financial liability in IAS 32 before considering whether it also meets the definition of a forgivable loan in IAS 20.

25. PwC also suggested removing the reference to limited diversity in practice from the agenda decision. On the basis of our outreach (as presented in Agenda Paper 7 for the Interpretations Committee's meeting in November 2015), we noted evidence of some diversity, but a majority of the respondents to our outreach noted that the most common approach in practice is to account for similar cash payments as liabilities. However, we are not opposed to revising the agenda decision to remove this reference.

26. Furthermore, we note that the Interpretations Committee's decision to not take the issue onto its agenda was based mainly on its view that the requirements in IFRS Standards provide an adequate basis for an entity to determine the accounting, rather than the evidence of limited diversity in practice. Consequently, we do not think that removing this reference affects the Interpretations Committee's decision to not take this issue onto its agenda. We have revised the proposed wording for the agenda decision as outlined in Appendix A.

27. We have also made some drafting amendments to the wording of the agenda decision to improve the flow and readability of the agenda decision. These are included in Appendix A.

Staff recommendation

28. On the basis of our analysis, we recommend confirming the tentative agenda decision as published in the *IFRIC Update* in November 2015 with some proposed drafting amendments. Appendix A of this paper sets out the draft wording for the final agenda decision for the Interpretations Committee's approval.

Question for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff recommendation to finalise the agenda decision? 2. Does the Interpretations Committee have any comments on the proposed wording of the final agenda decision set out in Appendix A to this paper?

Appendix A—Finalisation of agenda decision

A1. We propose the following wording for the final agenda decision (new text is underlined and deleted text is struck through)

IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*—Accounting for recoverable cash payments

The Interpretations Committee received a request to clarify ~~whether~~ the accounting for a cash payment~~s~~ ~~made by~~ received from a government to help an entity finance a research and development project. More specifically, the request asked whether the entity must recognise the cash payments ~~should be accounted for~~ as a liability ~~when received~~ (on the basis that the entity has received ~~it is~~ a forgivable loan as defined in IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*) or ~~recognised~~ in profit or loss ~~when received~~ (on the basis that ~~it is~~ the entity has received a government grant as defined in IAS 20). The cash payment received from the government is repayable ~~in cash~~ only if the entity decides to exploit and commercialise the results of the research phase of the project. The terms of the repayment can result in the government receiving up to twice the amount of the original cash payment if the project is successful. If the entity decides not to ~~proceed with~~ exploit and commercialise the results ~~from~~ of the research phase, the cash payment is not repayable, but instead ~~refundable and~~ the entity must transfer to the government the rights to the research.

The Interpretations Committee noted that, in this arrangement, the entity has ~~d~~ obtained financing for its research ~~&~~ and development project ~~and the appropriate accounting would depend on the specific terms and conditions of the cash payment received~~. The Interpretations Committee observed that the arrangement described in the submission ~~was~~ is a financial liability that the entity accounts for applying ~~within the scope of~~ IFRS 9 *Financial Instruments* (IAS 39 *Financial Instruments: Recognition*). The cash payment meets the definition of a financial liability (applying paragraph 20(a) of IAS 32 *Financial Instruments: Presentation*) because the entity can avoid a transfer of cash only by settling a non-financial obligation (ie by transferring the rights to the research to the government). ~~Many members of the Interpretations Committee thought that the arrangement also met the definition of a forgivable loan as defined in IAS 20~~.

The Interpretations Committee observed that judgement ~~would be~~ is required to determine ~~in making this assessment~~ whether the arrangement would also meet the definition of a forgivable loan in IAS 20 and, if so, ~~in determining~~ when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan.

The Interpretations Committee noted that the requirements in IFRS Standards provide an adequate basis ~~there was sufficient guidance in the Standards~~ to ~~help enable an entity to~~ determine the ~~appropriate~~ accounting for the cash payment received from a government. ~~The Interpretations Committee observed that diversity in practice appeared to be limited based on the feedback it had received from its outreach activities.~~

In the light of the requirements in existing IFRS Standards ~~requirements~~ ~~and the feedback received from its outreach activities~~, the Interpretations Committee determined that neither an Interpretation nor an amendment to a Standard was necessary. Consequently, the Interpretations Committee ~~and therefore [~~decided~~]~~ not to add this issue to its agenda.

Appendix B—Copies of comment letters

Deloitte.

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Wayne Upton
Chairman
IFRS Interpretations Committee
30 Cannon Street
London
United Kingdom
EC4M 6XH

18 January 2016

Dear Mr Upton

Tentative agenda decision – IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*: Accounting for recoverable cash payments

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the November IFRIC Update of the tentative decision not to take onto the Committee's agenda a request for clarification of whether a cash payment made by government to fund a research project that is repayable only if the entity decides to commercialise the project's output should be characterised as a financial liability or a government grant.

Whilst we agree that the conclusion that the specific instrument described is a financial liability is supportable and that judgement is required in determining whether the definitions in IAS 20 are met, we do not believe that the statement in the tentative agenda decision that "many members of the Interpretations Committee thought that the arrangement also met the definition of a forgivable loan" is helpful as this also implies that some members thought that it did not. We recommend that the tentative agenda decision include only statements upon which the Committee as a whole can reach consensus.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

MAZARS

Mr. Wayne Upton

IFRS Interpretation Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Paris, January 29, 2016

RE: IFRS Interpretations Committee tentative agenda decisions, November 2015

Dear Wayne,

MAZARS is pleased to comment on the various IFRS Interpretations Committee tentative agenda decisions published in the September IFRIC Update.

We have gathered all our comments as appendices to this letter. Should you prefer us to prepare separate comment letter for each tentative agenda decision, please let us know.

Should you have any questions regarding our comments, please do not hesitate to contact Michel Barbet-Massin (+33 1 49 97 62 27) or Edouard Fossat (+33 1 49 97 65 92).

Best regards,

Michel Barbet-Massin
Head of Financial Reporting
Technical Support

Edouard Fossat
Deputy Head of Financial Reporting
Technical Support

MAZARS

Appendix 4

IAS 20 Accounting for Government Grants and Disclosure of Government Assistance—Accounting for recoverable cash payments (Agenda Paper 7)

We agree with the IFRS Interpretations Committee's decision not to add this issue onto its agenda, and with the rationale expressed in the tentative agenda decision.

pwc

Mr Wayne Upton
Chairman of the IFRS Interpretation Committee
30 Cannon Street
London
EC4M 6XH

21 January 2016

Dear Mr Upton,

Tentative agenda decision: IAS 20 Accounting for Government Grants and Disclosure of Government Assistance—Accounting for recoverable cash payments (Agenda Paper 7)

We are responding to your invitation to comment on the above tentative agenda decision, published in the November 2015 edition of IFRIC Update, on behalf of PricewaterhouseCoopers. This response summarises the views of member firms that commented on the tentative agenda decision. 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We agree with the Committee's conclusion that this item should not be taken onto the agenda. However, we suggest that the draft agenda decision is revised in several areas.

Firstly, the Committee "observed that diversity in practice appeared to be limited". Our experience is that there are many different types of arrangement in which government or government agencies provide specific support to private entities in exchange for those entities complying with specific conditions. The different structures and objectives of these arrangements might give rise to different accounting. However, we have also observed diversity in the accounting that is applied to arrangements similar to those described in the agenda decision. We suggest the agenda decision is revised to remove the reference to there being limited diversity.

Secondly, the tentative agenda decision notes that the arrangements described are a financial liability within the scope of IFRS 9 *Financial Instruments* but does not explain the basis for this observation. It also implies that it is necessary to first assess whether an arrangement meets the definition of a financial liability before considering the guidance in IAS 20 *Government Grants* to determine whether the arrangement is also a forgivable loan. We do not believe the literature requires one standard to take precedence over the other in the absence of specific scope guidance. We suggest that the agenda decision is revised to describe the basis for the Committee's observations and to explain that an arrangement could meet the definition of both a forgivable loan and a financial liability.

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Finally, we agree that judgment is required to determine whether the arrangement meets the definition of a forgivable loan within the scope of IAS 20 and, if it does, when there is reasonable assurance that the loan will be forgiven.

If you have any questions, please contact Paul Fitzsimon, PwC Global Chief Accountant (+1 416 869 2322).

Yours sincerely

PricewaterhouseCoopers

PricewaterhouseCoopers

Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

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Berlin, 19 January 2016

Dear Wayne,

IFRS IC's tentative agenda decisions in its November 2015 meeting

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on several tentative agenda decisions taken by the IFRS IC, as published in the November 2015 *IFRIC Update*. Please find our detailed comments in the appendix to this letter.

If you would like to discuss our views further, please do not hesitate to contact Jan-Velten Große or me.

Yours sincerely,

Andreas Barckow
President

Appendix A – Comments on tentative agenda decisions

IAS 39/IFRS 9 – Derecognition of modified financial assets

We consider the decision being inappropriate given that there is an issue in practice. While the IFRS IC take the view that it is not appropriate to progress with the issue "at this time" and that it cannot be resolved "through an interpretation", we point to the fact that there are other means to address an issue, even in case it is a broad one. We suggest the IASB take action and deliberate a clarification as to how and when to derecognise modified financial assets and potentially charge the IFRS IC in developing respective proposals. Otherwise, we clearly see the danger that other parties, esp. out of the regulatory domain, will take the lack of clarity as a reason to develop second level GAAP.

IAS 39/IFRS 9 – Determining hedge effectiveness for net investment hedges

We agree with the decision.

IAS 20 – Accounting for recoverable cash payments

Generally, we are not convinced that the rationale for clarifying whether and how IAS 20 applies, i.e. whether there is a government grant (thus P/L recognition) or a forgivable loan (thus liability recognition), is appropriate. As per the IFRIC Update, many Committee members thought that the definition of a forgivable loan might be fulfilled, while the (full) Interpretations Committee clearly observed that there is a financial liability, which is contradictory in itself. Rather, fulfilling the definition of a forgivable loan is a necessary (but not sufficient) condition for recognising a financial liability.

In particular, we object to the finding that the arrangement described is a financial liability. Taking into account the (few) details given we would have concluded that fulfilling the conditions for a repayment is at the very discretion of the entity having received the cash payment; hence, there is clearly no financial liability.

IAS 32 – Offsetting and cash pooling

We agree with the decision for not taking the issue onto the IFRS IC's agenda, given the many different facts and circumstances existing in practice.

IAS 36 – Recoverable amount and carrying amount of a CGU

We agree with the IFRS IC's view that an answer being derived from the notion of IAS 36.78 provides for sufficiently clear guidance. However, we share the implicit question of whether the requirement of IAS 36.78 is appropriate in nature and whether this leaves room for a potential amendment to IAS 36, e.g. as part of the post-implementation review of the standard already initiated.

European Securities and Markets Authority

The Chair

Date: 25 January 2016
ESMA/2016/92

Wayne Upton
IFRS Interpretations Committee
30 Cannon Street
London
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United Kingdom

Ref: The IFRS Interpretations Committee's tentative agenda decisions on IAS 20 – Accounting for recoverable cash payments

Dear Mr Upton,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to respond to the IFRS Interpretations Committee's (IFRS IC) publication in the November 2015 IFRIC Update of the tentative agenda decision related to the application of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance.* We are pleased to provide you with the following comments with the aim of improving the consistent application and enforceability of IFRSs.

ESMA has considered the IFRS IC's tentative decision not to add to its agenda the request for clarification[1] it received whether cash payments made by a government to help an entity finance a research and development project should be accounted for as a liability (on the basis that it is a forgivable loan as defined in IAS 20) or recognised in profit or loss when received (on the basis that it is a government grant as defined in IAS 20).

ESMA notes that the IFRS IC observed that the arrangement described in the submission would give rise to a financial liability and that many members of the IFRS IC thought that the arrangement would also meet the definition of a forgivable loan.

ESMA agrees that arrangements described in the submission give rise to a financial liability, but considers that an analysis of the fact pattern, as described in the submission, should include the assessment whether there is a benefit of a government loan at a belowmarket rate as also suggested in the the staff paper's draft agenda decision:

[1] Letter to the IFRS IC: Agenda Item Request: Recoverable cash advances, 17 August 2015, ESMA/2015/1258

- The entity should first assess whether the cash payments by the government have favourable terms and are similar to a loan from the government at belowmarket rate. According to paragraph 10A of IAS 20 the benefit from a government loan at a belowmarket interest rate has to be treated as a government grant. The favourability in many of the arrangements similar to those described in the submission, is primarily related to the fact that the loans are forgivable, whereas the interest rate charged is a market-interest rate for a non-forgivable loan. Considering that the market-interest rate of a loan with similar terms and conditions and uncertainties for the lender could normally be expected to be higher than for a non-forgivable loan (especially because in the arrangements under examination the loan is not reimbursable at the discretion of the borrower), it could be argued that these arrangements seem to be similar to government loans at a belowmarket rate of interest.

- The remaining portion of the cash payment that is not a benefit is a forgivable loan. As the IFRS IC observed in its tentative decision agenda, judgment is required in making the assessment whether the loan will be forgiven.

ESMA has concerns that the interplay between paragraphs 10 and 10A of IAS 20 is not entirely clear. On the one hand, according to paragraph 10, the forgivable loan is only treated as a government grant once there is reasonable assurance for forgiveness. On the other hand, for the reasons above, it could be argued that forgivable loans, as described in the submission, are loans from government at belowmarket rate of interest for which, according to paragraph 10A of IAS 20, the benefit would have to be recognised already when the recoverable cash payments are received.

Therefore, ESMA recommends to amend the analysis in the agenda decision and urges the IFRS IC to complement the agenda decision in order to clarify whether the benefit provided by the government's recoverable cash payments (i.e. not reimbursable based on a borrower's decision to abandon a project) compared to a financing arrangement from other sources with similar terms and conditions (but without the forgivable character) should be accounted for as a government grant in accordance with IAS 20 (i.e. whether the forgivable character of the loan should be taken into account when determining the fair value of the loan at initial recognition).

We would be happy to discuss these issues further with you.

Yours sincerely,

Steven Maijoor