IFRS

STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*		
Paper topic	Accounting for repayable 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 repay 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 (eg 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 asked 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 first discussed this submission at its meeting in November 2015.[1] The Interpretations Committee observed that the cash payment gives rise to a financial liability within the scope of IFRS 9 *Financial Instruments*. The Interpretations Committee noted that the requirements in IFRS Standards provide an adequate basis for an entity to determine the accounting for this arrangement and tentatively decided not to add this issue to its agenda.

[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. At its meeting in March 2016, the Interpretations Committee discussed the feedback received on its tentative agenda decision.[2] At this meeting, the Interpretations Committee:

   (a) reaffirmed its conclusion that, in the fact pattern submitted, the cash payment received from the government gives rise to a financial liability for the entity;

   (b) decided to remove from the tentative agenda decision any reference to the arrangement also potentially meeting the definition of a forgivable loan; and

   (c) directed the staff to perform further analysis on how an entity accounts for any difference between the cash payment received from the government and the measurement of the financial liability at initial recognition.

6. The purpose of this paper is to:

   (a) provide an analysis of how an entity accounts for any difference between the cash payment received from the government and the measurement of the financial liability at initial recognition; and

   (b) ask the Interpretations Committee if it agrees with the staff recommendation to finalise the agenda decision.

Structure of the paper

7. This paper is organised as follows:

   (a) staff analysis;

   (b) staff recommendation and questions for the Interpretations Committee; and

   (c) Appendix A—Proposed wording for final agenda decision.

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[2] Agenda Paper 7 from the Interpretations Committee's meeting in March 2016 provides an analysis of the feedback received on the tentative agenda decision.

Staff analysis

8. Paragraph 5.1.1 of IFRS 9 states that (*emphasis added*):

> '…..at initial recognition, an entity shall measure a financial asset or *financial liability at its fair value* plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

9. Paragraph B5.1.1 of IFRS 9 states (*emphasis added*):

> 'The fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also paragraph B5.1.2A and IFRS 13). However, *if part of the consideration given or received is for something other than the financial instrument*, an entity shall measure the fair value of the financial instrument. For example, the fair value of a long-term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset.'

10. Accordingly, we think that the entity first determines the fair value of the financial liability that arises from the cash payment received from the government. If there is a difference between the cash proceeds received from the government and the fair value of the financial liability, the entity assesses whether that difference relates to something other than the financial liability. This assessment depends on the relevant facts and circumstances applicable to the cash payment.

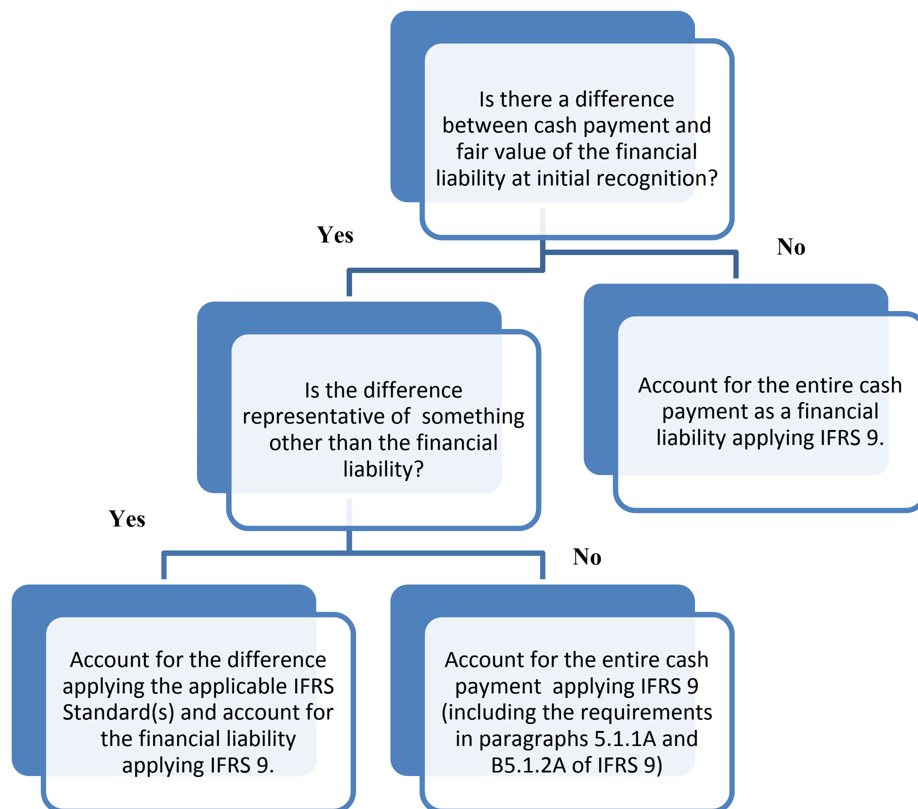
11. If an entity concludes that the difference between the cash proceeds and the fair value of the financial liability relates to something other than the financial liability, then the entity accounts for that difference applying the applicable IFRS Standard(s).

12. If an entity concludes that there is nothing else in the transaction except for the financial liability, then the entity applies the requirements in paragraph B.5.1.2A of IFRS 9.

13. Paragraph B5.1.2A states:

> 'The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also IFRS 13). If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 5.1.1A, the entity shall account for that instrument at that date as follows:
>
> (a) at the measurement required by paragraph 5.1.1 if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) or based on a valuation technique that uses only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.
>
> (b) in all other cases, at the measurement required by paragraph 5.1.1, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

14. The following flowchart illustrates the appropriate accounting for the cash payment and any difference between the cash payment and the fair value of the financial liability.



15. We think that, in the fact pattern submitted, any difference may represent assistance received from the government to enable the entity to further its R&D project (ie a government grant within the scope of IAS 20). In the following paragraphs, we have outlined the accounting treatment that applies in cases in which an entity concludes that the difference represents a government grant within the scope of IAS 20.

Accounting for the difference if it represents a government grant

16. If the difference between the cash payment and the fair value of the financial liability at initial recognition represents a government grant, the entity accounts for the difference applying the requirements of IAS 20.

17. Paragraph 7 of IAS 20 states that:

> Government grants, including non-monetary grants at fair value, shall not be recognised until there is reasonable assurance that:

> (a) the entity will comply with the conditions attaching to them; and
>
> (b) the grants will be received.

18. Paragraph 12 of IAS 20 states:

> Government grants shall be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate.

19. The assessment of when the conditions in paragraph 7 of IAS 20 are met and the assessment of the related costs for which the grant is intended to compensate will depend on the relevant facts and circumstances. In the fact pattern submitted, we think that the government has provided assistance to the entity to *continue* its R&D project (given that the government grant is provided only in conjunction with the financial liability). Accordingly, even though the cash payment is calculated based on expenses that were incurred in the past, we think that the grant is intended to compensate the entity for future costs that it will incur on its R&D project. Accordingly, we think that the entity defers the recognition of the grant when the cash payment is received.

20. For example, an entity receives a cash payment of CU100,000 from the government. The terms of the cash payment stipulate that the entity is required to repay the government at the end of three years if it decides to exploit the results from the research phase of the project. The amount that the entity repays depends on the success of the project.

21. Applying IFRS 13 *Fair Value Measurement*, the entity determines that the fair value of its financial liability (ie its obligation to repay the government) is CU80,000.

22. Accordingly, there is a difference of CU20,000 between the cash payment of CU100,000 and the fair value of the financial liability of CU80,000. Having considered the relevant facts and circumstances, the entity determines that the difference represents a government grant because the government has provided assistance to the entity to continue its R&D project.

23. Accordingly, when the entity receives the cash payment, it records the following:

Dr Cash	CU100,000	
Cr Financial liability		CU80,000
Cr Government grant (deferred credit)		CU20,000

24. After initial recognition, the entity will apply the requirements of IFRS 9 to account for the financial liability and the requirements of IAS 20 to account for the government grant deferred credit. Applying paragraph 12 of IAS 20, the entity will recognise the government grant in profit or loss over the periods in which it recognises as expenses the related costs for which the grant is intended to compensate.

Staff conclusion and recommendation

25. We think that the requirements in IFRS Standards provide an adequate basis to enable an entity to determine how to account for the arrangement.

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

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~~ repayable 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 payment ~~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~~ that 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~~ cash payment described in the submission ~~was~~ gives rise to 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). The entity accounts for that financial liability applying ~~within the scope of~~ IFRS 9 *Financial Instruments* (IAS 39 *Financial Instruments:*

Recognition and Measurement).

~~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 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.~~

The Interpretations Committee noted that, applying paragraph B5.1.1 of IFRS 9 (paragraph AG64 of IAS 39), the entity assesses at initial recognition whether part of the cash payment received from the government is for something other than the financial instrument. For example, in the fact pattern described in the submission, part of the cash payment received (the difference between the cash payment received and the fair value of the financial liability) may represent a government grant. If this is the case, the entity accounts for the government grant applying IAS 20.

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 existing 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.