IFRS

STAFF PAPER

November 2015

IFRS Interpretations Committee Meeting

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

CONTACT(S) Jawaid Dossani jdossani@ifrs.org +44 (0)20 7332 2742

This paper has been prepared by the staff for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Introduction

1. The IFRS Interpretations Committee ('the Interpretations Committee') received a request to clarify whether cash payments made by a government to help an entity finance a particular research and development project (hereafter referred to as 'the R&D project') should be recorded as revenue upon receipt or if it should be recorded as a liability. The cash payments are repayable to the government if the entity decides to exploit and commercialise the results of the R&D project.

2. The objective of this Agenda Paper is to provide the Interpretations Committee with a summary of the issue and the staff's research, analysis and recommendation.

3. The submission is reproduced in full in Appendix B of this Agenda Paper.

Structure of the paper

4. This paper is organised as follows:

    (a) background information;

    (b) summary of outreach conducted;

    (c) staff analysis;

    (d) assessment against the Interpretations Committee's agenda criteria;

    (e) staff recommendation;

(f) questions for the Interpretations Committee;

(g) Appendix A—Proposed wording for tentative agenda decision; and

(h) Appendix B—Submission.

Background information

The issue

5. The submitter describes a scenario in which:

   (a) a cash payment is made by a government 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 its research expenses that have been 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 to abandon the project), the cash payment is not refundable. In this case, the rights related to the results of the research phase are transferred to the government.

   (c) the cash payment is refundable if the entity decides to exploit and commercialise the results from the research phase of the R&D project. A certain portion of the repayment is fixed and is payable over a 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 an entity starts exploiting the results but decides after some time to abandon the R&D project, the entity is exempted from future repayments, provided that certain conditions are met (ie formal notification providing explanations showing that the decision is based on rational grounds such as a negative development in the economic, technological or legal environment). In such cases, the rights attached to the R&D project are transferred to the government.

   (e) in typical scenarios, the 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 (in cases in which the project is successful).

6. The issue is whether the entity should recognise the cash payment as a forgivable loan in accordance with IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* and therefore recognise a liability upon receipt of the cash payment or if the entity should record the cash payment as revenue (ie a government grant) upon receipt.

7. The submitter has identified the following two divergent views that have developed in practice:

   (a) View 1—the cash payment is treated as a forgivable loan; and

   (b) View 2—the cash payment is treated as a government grant when received.

View 1—the cash payment is treated as a forgivable loan

8. Proponents of this view think that the cash payment meets the definition of a forgivable loan in accordance with paragraph 3 of IAS 20. Consistent with the requirements of paragraph 10 of IAS 20, they think that the cash payment can only be recognised as a government grant when there is reasonable assurance that the terms for forgiveness will be met (ie when there is reasonable assurance that the entity will abandon the R&D project).

9. Proponents of this view think that if, upon receipt of the cash payment, there is no reasonable assurance that the project will be abandoned and the full amount of the loan will be forgiven, the cash payment cannot be recorded as a government grant in its entirety upon receipt.

10. However, if upon receipt of the cash payment the likelihood that an entity will earn any significant revenue within the reimbursement period is small, it may be argued that there is reasonable assurance that a portion of the reimbursement that is dependent on revenue will be forgiven and the entity may be able to record that portion as a government grant upon receipt.

View 2—the cash payment is treated as a government grant when received

11. Proponents of this view think that the cash payment should be accounted for as a government grant when received and should be recorded in operating income. The cash payment should not be deferred, because it is linked to costs already incurred.

12. Proponents of this view think that, in substance, the cash payment is a government grant with conditional repayment features, which is different from a forgivable loan. Paragraph 32 of IAS 20 notes that a government grant that becomes repayable shall be accounted for as a change in estimate. Consequently, they think that when an entity decides to exploit the results of the research phase of the R&D project, the cash payment becomes refundable and at that moment, a financial liability is recognised and debited to the statement of comprehensive income.

13. Proponents of this view also argue that no liability can be recognised until the decision to exploit has been made by the entity, because the definition of a financial liability in paragraph 11 of IAS 32 has not been met. This is because the decision to exploit is within the entity's control and there is no contractual obligation to deliver cash to the government until this decision has been made.

Summary of outreach conducted

14. In order to gather information about the issue described in the submission, we sent requests to the International Forum of Accounting Standard-Setters, regulators, and global accounting firms. Specifically, we asked:

    Q1. How common are recoverable cash advances made by the government (with these or other similar characteristics) in your jurisdiction?

    Q2. If possible, please provide examples of such transactions that you have observed in practice. Ideally, these would be examples from published financial statements, but examples provided on a confidential basis will also be useful.

    Q3. If the transaction is common in your jurisdiction, please identify:

    (a) what is the predominant approach you observe in practice for accounting for previously held interests in these transactions; and

    (b) have you observed any diversity in practice in accounting for such cash advances?

We also asked respondents to explain the basis on which they had prepared their response. For example, if they conducted their own outreach we asked them to tell us the type of stakeholders that responded (for example, preparers under IFRS in their jurisdictions).

15. The views received represent informal opinions and do not reflect the formal views of those organisations.

Responses from national standard-setters

16. We received 10 responses from national standard-setters. The geographical breakdown for the responses received from the national standard-setters is as follows:

Geographical region	Number of respondents
Asia	3
Europe	3
Americas	2
Oceania	1
Africa	1
Total respondents	**10**

17. Almost all of the respondents indicated that these types of arrangements were not common within their respective jurisdictions.

18. One respondent noted that they had observed some cash payments being provided by the government to entities which would be repayable if the project was successful. The respondent noted that these advances were generally accounted for as forgivable loans until there was reasonable assurance that the entity will meet the terms for forgiveness of the cash payment. Another respondent noted that they have observed grants that have been given by the government whereby the grant is refundable if a company cannot fulfil its obligations. These grants are recorded as a liability until all conditions are met.

19. One respondent noted that the fact pattern seemed to be simplified and thought that similar issues could exist in practice, in particular with regard to R&D activities and start-up companies if more facts were known.

20. One respondent noted that while the issue was not common, they had received mixed views from constituents on the appropriate accounting treatment. Another respondent noted that they had received a comment from an analyst who supported View 1 (ie accounting for the cash payment as a forgivable loan).

21. One respondent thought that if the settlement contingency was within the control of the issuer, the definition of a financial liability would not be met. However, in their view, it remained debatable as to whether the payment should be recorded in comprehensive income when received or if a different accounting treatment (eg recognising deferred income) would be more appropriate.

Responses from regulators

22. We received one response from an organisation representing a group of regulators. One of their members noted that the issue had been seen in their jurisdiction and had been accounted for as a government grant when received. Another member noted that they were aware of a couple of instances in which government grants had been advanced but were repayable based on certain conditions. In those instances, the funding had been recognised as a government grant, because management had assessed the entity as being in compliance with the conditions.

Responses from accounting networks

23. We received responses from the global IFRS groups of six accounting networks.

24. Two of the respondents noted that the issue was not particularly common but had been encountered in some jurisdictions. One respondent noted that refundable cash advances have been seen in several countries. One respondent noted that they have seen similar transactions but not ones in which the government has the right to acquire the intellectual property if the entity decides not to exploit the results of the R&D project.

25. One respondent noted that they have observed several instances of payments from the government being refundable if the research is unsuccessful or if sufficient progress in not made on a particular project. However, the respondent observed that these

payments are generally accounted for as forgivable loans with little or no diversity in practice. Another respondent commented that there are also a wide range of similar arrangements involving research funding from a financial institution or from a charity.

26. One respondent noted that they had come across a similar situation some years ago in one jurisdiction and in the specific facts and circumstances of that case, the conclusion was that the cash payment should be accounted for as a liability initially, and a government grant subsequently, if the 'reasonable assurance' test was met.

27. Almost all respondents noted that the predominant approach is to treat the payments as forgivable loans, although two respondents noted that they have observed both views described in the outreach being applied in practice. One respondent thought that the wording in IAS 20 was open to interpretation and could lead to diversity in practice.

28. One respondent questioned whether the assessment of the payment as a forgivable loan or a government grant would have a substantial effect in profit or loss, because they thought that the credit to income should only be recognised when the entity is reasonably assured that it will be entitled to retain the funds received. The respondent acknowledged that the classification of the payment could affect how the liability is presented in the balance sheet (eg as a financial liability or as deferred income).

29. One respondent thought that the entity had an obligation towards the government in all cases, whether they decide to exploit or abandon the R&D project, and the appropriate accounting would depend on the facts and circumstances of the arrangement. The respondent also thought the government could be sharing the risks and rewards of the entity's R&D project.

30. One respondent noted that while accounting for the payment as a forgivable loan was the most common approach, there was diversity in determining the time at which an entity concludes there is no longer reasonable assurance that a grant will be received. The respondent also highlighted that IAS 41 *Agriculture* requires a government grant related to a biological asset to be recognised when the conditions attached to the grant are met, rather than when there is 'reasonable assurance' that the conditions will be met, which, in its opinion, seemed inconsistent with the guidance in IAS 20.

Staff analysis

31. Paragraph 3 of IAS 20 provides the following definitions, which are relevant to the analysis (emphasis added):

> *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 assistance for the purpose of this Standard does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.
>
> *Government grants* are 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. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.
>
> *Forgivable loans* are loans which the lender undertakes to waive repayment of under certain prescribed conditions.

32. Conceptually, we do not think that viewing the cash payment as a forgivable loan or a government grant with conditional repayment features should result in a significantly different accounting treatment.

33. Paragraph 7 of IAS 20 states:

> 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

34. Paragraph 10 of IAS 20 states:

> A forgivable loan from government is treated as a government grant when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan.

35. In either case, we note that the Standard requires that there should be reasonable assurance that the terms or conditions attached to the cash payment will be met. For the cash payment, we think that abandoning the R&D project can either be viewed as a term of a forgivable loan or a condition of a government grant. In either case, we think that there must be reasonable assurance that the R&D project will be abandoned before the entity can record the cash payment in profit or loss. In our view, this should result in a similar accounting treatment regardless of whether the cash payment is viewed as a forgivable loan or as a government grant.

36. However, we think determining the appropriate accounting of the cash payment that has been described in the submission is more complex and requires further consideration. We do not think it is appropriate to view the entire cash payment as a forgivable loan or a government grant without further analysis. We discuss this in more detail in the following paragraphs.

37. In our view, the substance of the arrangement is that the government has made an investment in the R&D project of the entity. The government has effectively provided funds to the entity and in return is exposed to the risks and rewards of the R&D project. In the event that the R&D project is successful, the government will receive a return of up to twice its original investment, and in the event of a failure, it is exposed to the risk of a loss of its investment (the government will receive the rights to the R&D project but these rights could have limited or no value when abandoned by the entity).

38. Paragraph 1(c) of IAS 20 states that government participation in the ownership of an entity is outside the scope of IAS 20. In our view, the entity should first assess whether the investment provides the government with ownership interests in the entity. This assessment is dependent on the specific terms and conditions of the cash payment. We do not have sufficient information to make this assessment. For the remainder of our analysis, we have assumed that the cash payment does not provide the government with participation in the ownership of the entity.

39. A government grant should provide an economic benefit to an entity (see the definition in paragraph 20). We do not think that the entity receives an economic benefit for the entire amount of the cash payment until such time as there is reasonable assurance that the R&D project will be abandoned. This is because the entity is required to repay the principal amount of the cash payment together with an additional return that could result in a repayment of up to twice the initial cash payment.

40. It is possible that the terms and conditions of the cash payment received from the government are more favourable than what the entity could have obtained for financing from other sources. If this is the case, then we think that the cash payment has characteristics that are similar to a government loan at a below-market rate of interest.

41. Paragraph 10A discusses the appropriate accounting for a government loan at a below-market rate and states:

> The benefit of a government loan at a below-market rate of interest is treated as a government grant. The loan shall be recognised and measured in accordance with IFRS 9 *Financial Instruments*. The benefit of the below-market rate of interest shall be measured as the difference between the initial carrying value of the loan determined in accordance with IFRS 9 and the proceeds received. The benefit is accounted for in accordance with this Standard. The entity shall consider the conditions and obligations that have been, or must be, met when identifying the costs for which the benefit of the loan is intended to compensate.

42. In our view, the entity should determine the benefit conferred by the government by comparing the proceeds of the cash payment received from the government with the fair value of a financing arrangement with similar terms and conditions. The benefit portion of the cash payment should then be accounted for as a government grant in accordance with the requirements of IAS 20.

43. We think that the remaining portion of the cash payment that is not a benefit is in substance a loan that has been received from the government and should be accounted

for under IFRS 9 *Financial Instruments*. While the entity may be able to decide to abandon the project, we do not think this implies that the entity does not have an obligation. We think this is similar to a non-recourse loan (for example, a non-recourse mortgage loan on a property whereby the lender is only entitled to the property in the event of default), because the government will receive the rights to the R&D programme in the event the entity abandons the R&D programme.

44. We think it is quite possible that the rights to the R&D project could have limited to no value at the time the entity decides to abandon the R&D project and in substance the government will forgive the loan at that stage. Consequently, we think that the loan also meets the definition of a forgivable loan in paragraph 3 of IAS 20.

45. In our view, this loan should be accounted for under IFRS 9 until there is reasonable assurance that the R&D project will not be successful and the entity will abandon the project and meet the terms for forgiveness for all or for a portion of the loan. In accordance with the requirements of paragraph 10 of IAS 20, we think that the loan or the portion of the loan to be forgiven will then become a government grant under IAS 20.

Conclusion

46. We think that the entity has obtained financing for its R&D project and the appropriate accounting will depend on the specific terms and conditions of the cash payment received. We think the entity should consider, among other things, the following factors in determining the appropriate accounting for the cash payment:

    (a) whether the terms of the cash payment provide the government with participation in the ownership of the entity. Government participation in the ownership of an entity is excluded from the scope of IAS 20 and should be accounted for in accordance with other relevant Standards; and

    (b) to the extent that the cash payment does not represent government participation in the ownership of the entity:

        (i) whether the cash payment has favourable terms and is similar to a loan from a government at below-market rates, in which case

the entity should apply the guidance in paragraph 10A of IAS 20; and

(ii) whether the remaining portion of the cash payment that is not a benefit is in substance a loan that has been received from the government and should be accounted for under IFRS 9. We think that the loan would also meet the definition of a forgivable loan and should be accounted for in accordance with the guidance on forgivable loans in IAS 20.

47. We consider that there is sufficient guidance in IAS 20 and other Standards to help an entity determine the appropriate accounting for the cash payment.

Assessment against the Interpretations Committee's agenda criteria

48. We have assessed this issue against the agenda criteria of the current *Due Process Handbook*:

Paragraph 5.16 states that the Interpretations Committee should address issues:	Agenda criteria satisfied?
that have widespread effect and have, or are expected to have, a material effect on those affected;	**Yes.** We think while a large number of respondents noted that they have limited experience with these transactions, there are indications that the issue is common and could be widespread in certain jurisdictions.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and	**No.** We think that there is sufficient guidance in existing Standards to determine the appropriate accounting for the cash payment described in the submission. In addition, based on the feedback received from our outreach activities, we think that diversity in practice is limited.

Paragraph 5.16 states that the Interpretations Committee should address issues:	Agenda criteria satisfied?
that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*.	Not applicable.
In addition:	
Can the Interpretations Committee address this issue in an efficient manner (paragraph 5.17)?	Not applicable.
The solution developed should be effective for a reasonable time period. (paragraph 5.21)	Not applicable.

Staff recommendation

49. On the basis of our analysis, the feedback received from outreach activities and our assessment of the Interpretations Committee's agenda criteria, we recommend that the Interpretations Committee should not take the issue onto its agenda.

50. We have set out the proposed wording for a tentative agenda decision in **Appendix A** of this paper.

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with our analysis and recommendation not to take this issue onto its agenda? 2. If the Interpretations Committee agrees with our recommendation, does it agree with the proposed wording of the tentative agenda decision as set out in Appendix A?

Appendix A
Proposed wording for tentative agenda decision

IAS 23 *Accounting for Government Grants and Disclosure of Government Assistance*—Accounting for recoverable cash payments

The IFRS Interpretations Committee ('the Interpretations Committee') received a request to clarify whether cash payments made by a government to help an entity finance a research and development project should be accounted for as a liability (ie a forgivable loan as defined in IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*) when received or as revenue (ie a government grant as defined in IAS 20) when received. The cash payment received from the government is repayable 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 the results from the research phase, the cash payment is not refundable and the government receives the rights to the research.

The Interpretations Committee noted that the entity had obtained financing for its R&D project and the appropriate accounting would depend on the specific terms and conditions of the cash payment received. The Interpretations Committee noted that the entity should consider, among other things, the following factors in determining the appropriate accounting for the cash payment:

(a) whether the terms of the cash payment provide the government with participation in the ownership of the entity. Government participation in the ownership of an entity is excluded from the scope of IAS 20 and should be accounted for in accordance with other relevant Standards; and

(b) to the extent that the cash payment does not represent government participation in the ownership of the entity:

(i) whether the cash payment has favourable terms and is similar to a loan from a government at below-market rates, in which case the entity should apply the guidance in paragraph 10A of IAS 20; and

(ii) whether the remaining portion of the cash payment that is not a benefit is in substance a loan that has been received from the government and should be accounted for

under IFRS 9. We think that the loan would also meet the definition of a forgivable loan and should be accounted for in accordance with the guidance on forgivable loans in IAS 20.

The Interpretations Committee noted that there was sufficient guidance in the Standards to help determine the appropriate accounting for the cash payment received from a government. The Interpretations Committee observed that it had not received evidence of significant diversity in practice.

In the light of existing IFRS 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 and therefore [decided] not to add this issue to its agenda.

Appendix B
Submission

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

Agenda Item Request: Recoverable cash advances

Dear Mr. Upton,

The European Securities and Markets Authority (ESMA) is an independent EU Authority that contributes to enhancing the protection of investors and promoting stable and well-functioning financial markets in the European Union (EU). ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. ESMA contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.

As a result of the reviews of financial statements carried out by national competent authorities and ESMA's co-ordination activities, we have identified an issue related to the application of IAS 20 Accounting for Government Grants and Disclosure of Government Assistance related to accounting for recoverable cash advances.

A detailed description of the case is set out in the appendix to this letter.

We would be happy to further discuss this issue with you.

Yours sincerely,

Steven Maijoor

Chair

European Securities and Markets Authority

APPENDIX – DETAILED DESCRIPTION OF THE ISSUE

1. As part of their monitoring and supervisory activities, ESMA and national enforcers have identified divergent application of requirements of IAS 20 regarding the accounting for recoverable cash advances (RCA). Specifically, divergence in practice exists regarding accounting of RCA funding provided by government that is recoverable, based on certain conditions. The main issue is whether a financial liability should be recognised upon receipt of the RCA, to take into account the recoverable portion of the cash advance.

Description of the issue

2. The government provides financial support to private entities for their experimental development programmes.[1] The government's financial support takes the form of either a subsidy or a RCA. RCA contracts are divided in three phases, i.e., the 'research phase', the 'decision phase' and the 'exploitation phase'.[2]

3. During the research phase, the issuer receives funds from the government in order to cover 60 % of the expenses incurred (the total of the funds received are called hereafter the 'principal amount'). At the end of the research phase (which can take about 12 to 24 months), the issuer should, within a period of six months, decide to exploit the results of the research programme or abandon it. If the issuer decides to exploit and commercialise the research results, the corresponding RCA becomes refundable (in full or partially).

4. The reimbursements of the RCAs to the government are of two different types, i.e. turnover-independent reimbursements (annual lump-sums) and turnover-dependent reimbursements (a fixed percentage of the turnover). The triggers for those reimbursements are different. The trigger for the turnover-independent reimbursements is the entity's decision to start to exploit the results of the research programme whereas turnover-dependent reimbursements are only to be made when an

---

[1] This type of government assistance is relatively common in member states of the European Union, based on the EU community framework for state aid for research and development and innovation (2006/C 323/01).

[2] Exploitation does not mean immediate commercialisation. It can mean the use of the research results for the further development of a product. Typically, the issuer will earn revenue from the development several years after the 'decision phase'.

entity earns revenue from the development (which generally occurs several years after the decision to exploit the R&D programme is taken).

5. For instance, in a typical example the turnover-independent reimbursements are fixed by contract at 30% of the principal amount and are spread over a period of 10 years, and the annual turnover-dependent reimbursements are fixed at 5% of annual turnover.[3] The amount reimbursed can increase up to a maximum of 200% of the principal amount in case the project is successful (i.e. if the entity decides to exploit the results of the research programme and a certain predetermined turnover threshold is exceeded), or be limited to a minimum of 50% of the principal amount in case the project is not successful (i.e. if the entity decides to exploit the results of the research programme but the turnover does not exceed a certain threshold).

6. If the issuer decides to abandon the project after the research phase, the RCA is not refundable and the rights related to the results of the research phase are transferred to the government.

7. The contract allows an issuer to initially start the exploitation phase (with the resulting repayment of the RCA), and to decide after some time to renounce the exploitation of the programme. In this case, the issuer is exempted from future repayments as of the calendar year after such decision is taken if certain formal conditions are met (i.e. formal notification providing explanations showing that the decision is based on rational grounds such as a negative development in the economic, technological or legal environment). In such situations, the rights attached to the R&D programme are transferred to the government and the issuer is prohibited from using, exploiting or selling any product or service that is (even partially) based on the results of the development project. All the amounts paid back to the government, before the decision to abandon the project is taken, remain the government's property.

View 1 – Recognition of a liability for a recoverable part of RCA

8. Proponents of View 1 argue that, upon receipt, RCAs are recognized as government grants only when there is reasonable assurance that the terms for forgiveness will be met. When this is not the case a liability should be recognised.

---

[3] usually in this type of contracts the range is between 0.18% and 5% of annual turnover

9. Proponents of this view argue that RCAs meet the definition of a forgivable loan defined in paragraph 3 of IAS 20 as 'loan which the lender undertakes to waive repayment of under certain prescribed conditions'. Paragraph 10 of IAS 20 requires a forgivable loan from government to be treated as a government grant only when there is a reasonable assurance that the entity will meet the terms for forgiveness of the loan.

10. IAS 20 does not provide a definition of '*reasonable assurance*'. However, IAS 41 *Agriculture* deals with government grants related to a biological asset. Paragraph B69 of the Basis for Conclusions on IAS 41 states that ‘it would inevitably be a subjective decision as to when there is reasonable assurance that the conditions are met and that this subjectivity could lead to inconsistent income recognition’. Paragraph B70 outlines two alternative approaches for deciding whether an entity should recognise a conditional government grant under IAS 41: (a) when ‘it is probable that the entity will meet the conditions attaching to the government grant’ and (b) when ‘the entity meets the conditions attaching to the government grant’. Paragraph B73 states that the Board concluded that approach (b) is the more appropriate and thus paragraph 35 of IAS 41 explicitly requires that a government grant should only be recognised when the conditions attached to it are met. Therefore, proponents of the View 1 argue that ‘reasonable assurance’ is on a scale between ‘probable’ (‘more likely than not’)[4] and ‘certain’. Consequently, an entity cannot recognise government grants before it is at least more likely than not that it complies with the conditions attached to them.

11. If upon receipt of the RCA there is no reasonable assurance that the project will be fully abandoned before the exploitation phase (for example, because similar projects with similar risks continue in the exploitation phase), and therefore there is no reasonable assurance that the full amount of the principal loan will be forgiven, then the RCA cannot be accounted for as government grant in its entirety.

12. Proponents of this view argue that, when analysing whether there is reasonable assurance that an entity will meet the terms for forgiveness of the loan, it might be necessary to make a distinction between the turnover-dependent and turnover-

[4] Appendix A of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* or paragraph 23 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

independent reimbursements as the criteria triggering their respective repayments are different. As indicated above, turnover dependent-reimbursements have only to be made when an entity earns revenue from the development, whereas the trigger for the turnover-independent reimbursements is the entity's decision to start to exploit the results of the research program.

13. Therefore, considering a situation where the issuer until now decided to start exploitation of the results in almost all funded programs, it is not probable upon receipt that the turnover-independent reimbursements will be forgiven. Consequently, no reasonable assurance exist that the terms for forgiveness of this part of the loan (30% in the case described) are met and the liability for this part of the loan should be recognised.

14. However, when upon receipt of the loan the likelihood that an entity will actually earn any significant revenue within a period of 10 years from the exploitation is small, it can be argued that reasonable assurance exists that the terms for forgiveness of a portion[5] of the turnover-dependent part of the loan are met. Therefore, the turnover-dependent reimbursements that are expected not to be repaid should be accounted as government grant in operating income.

View 2 – accounting of the full RCA as a government grant

15. Proponents of View 2 argue that, upon receipt, the full amount of advances should be accounted for as government grants in operating income. The advances should not be deferred as they are linked to costs already incurred. If the beneficiary of the RCA decides to exploit the results of the RCA, the relevant RCA becomes refundable and a liability and an operating expense for the full RCA received is recognised.

16. Proponents of this view argue that no liability can be recognised until the decision to exploit because the definition of a financial liability in paragraph 11 of IAS 32 *Financial Instruments: Presentation* is not met. Accordingly, there is no contractual obligation to deliver cash to the government as it is the issuer's own decision to exploit the results of the research phase and therefore the obligation to reimburse can

[5] As explained in paragraph 5 a minimum of 50% of the principle amount has to be reimbursed if the project is exploited even if unsuccessfully

be avoided (assessment at the time when the decision whether to exploit the results is made).

17. Furthermore, when the eligible expenses or losses have already been incurred, government grants are recognised as a profit in the period in which the issuer is qualified to receive it, as required by paragraph 20 of IAS 20. As in substance RCAs are government grants with conditional repayment features which are different from forgivable loans that might become government grants if certain conditions are met, paragraph 10 of IAS 20 cannot be applied.

18. As the grant is recognised only after the expenses have been incurred and after the subsidy has been cashed in, there is a certitude (rather than only a 'reasonable assurance') that the entity complies with the conditions attached to it and thus that the grant has been received. The decision to exploit the results remains at any time in the hand of the issuer so that the reimbursement can be avoided if the entity decides so.

19. According to paragraph 32 of IAS 20 when a government grant becomes repayable, it shall be accounted for as a change in accounting estimate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Therefore, in the event the company decides to exploit the results under an RCA, the relevant RCA becomes refundable and at that moment a financial liability is recognised and debited to the statement of comprehensive income.

Request

20. ESMA seeks clarification on whether RCAs should be recognised as government grant or as forgivable loan and whether distinction should be made between the turnover-dependent and turnover-independent reimbursements. Furthermore, ESMA requests clarification on whether the fact that the decision to exploit the results remains at all time in the hands of the issuer and that the reimbursement can be avoided under certain conditions have an impact on the analysis. Consequently, if a part of the RCA cannot be treated as a government grant, ESMA seeks clarification on whether a financial liability should be recognised upon receipt of the RCA.

21. ESMA is aware of divergent practices in various European jurisdictions. Accordingly, ESMA kindly suggests that the IFRS Interpretations Committee considers clarifying the accounting requirements in this respect.