In brief
A look at current financial reporting issues

1 August 2016

Accounting for government loans to fund research and development

Issue

The IFRS Interpretations Committee (IC) has concluded that contingently repayable cash received from a government to finance a research and development (R&D) project is a financial liability under IFRS 9, 'Financial instruments' (same conclusion under IAS 32, 'Financial instruments; Presentation'). The liability is initially recognised at fair value, any difference between the cash received and the fair value of the liability is a government grant, accounted for under IAS 20, 'Government grants'.

The fact pattern submitted to the IC was:

- The government gives cash to an entity for qualifying research project.
- The cash is repayable if the entity decides to exploit and commercialise the results of the research project (the project is successful).
- The research results are transferred to the government if the entity decides to abandon the project.

The IC issued an agenda decision and concluded that this arrangement was a financial liability. The entity can only avoid delivering cash by settling with a non-financial obligation (the research results.) The cash receipt was not in the scope of IAS 20 as the entity would repay in cash or assets and so the loan is not 'forgiven'. [IAS 32 para 20.]

Impact

Who will be affected?

Similar funding arrangements are available from many different governments; the requirement to deliver the results on the research project on abandonment is usually included to comply with competition law. Government schemes of this type are most likely to be used by smaller biotech and pharma companies, often in the start up period.

However, R&D funding in the pharmaceutical industry comes from many sources, including venture capitalists (VC), governments and charitable organisations. The fact pattern considered by the IC was very specific but has broader implications for any arrangement that has similar characteristics.

A VC might finance an R&D project for a start up pharma company. Repayment is triggered by commercialisation of the drug and may be fixed or a percentage of sales. The pharma company will be required to transfer any intellectual property or research result to the VC if the pharma company chooses not to commercialise or the research fails. Many regulators will look at the IC agenda decision and expect that similar fact patterns should also be treated as a financial liability. The requirement to transfer the intellectual property protects the interest of the VC in situations where the commercialisation of drug might not be an attractive prospect for the pharma company.

Charitable organisations often support the search for a cure for a specific disease or condition or more broadly support research and science projects. A grant from a charitable organisation may include the same broad features as the government scheme or VC funding. The trustees of the charity have a duty to ensure that the charity does not enrich a commercial organisation such as a pharma start up without sharing in any beneficial outcome.

What is the impact?

Entities that obtain assistance from the government, charitable organisations or other parties with similar terms should consider the impact of the agenda decision on their current accounting. It is likely that they should recognise a financial liability when cash is received in accordance with the provisions of IFRS 9 (IAS 32/39).

When is the agenda decision effective?

The agenda decision is effective immediately. It clarifies the IC's view of the accounting treatment that should always have been followed. The revised presentation should be accounted for as a change in accounting policy. It will therefore need to be accounted for retrospectively and comparative amounts should be restated.

Where can entities get more details?

See the May 2016 IFRIC update for the full agenda decision.

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