STAFF PAPER

25 January – 27 January 2012

IASB Meeting

Project	**Amendments to IFRS 1**
Paper topic	Government loans – Comment letter analysis

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Purpose of this paper

1. The purpose of this paper is to document the staff analysis of comment letters received on the exposure draft *Government Loans (Proposed amendment to IFRS 1 First-time adoption of International Financial Reporting Standards)* published in October 2011, and to present the staff recommendation for finalising the amendment.

2. This paper:

   (a) provides background information of this issue;

   (b) provides a summary of the comment letters received;

   (c) provides an analysis of specific comments, including staff recommendations thereon; and

   (d) asks the Board whether they agree with the staff recommendation.

Background of the issue

3. In August 2011, the IASB (the Board) received a request to amend IFRS 1 to allow first-time adopters of IFRSs the same prospective application provisions

in certain IFRSs as have been made available to existing preparers of IFRS financial statements.

4. IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* requires entities to measure government loans with a below-market rate of interest at fair value on initial recognition. This requirement was incorporated into IAS 20 in 2008 by the addition of paragraph 10A. A first-time adopter applying IAS 20 retrospectively to existing government loans at the date of transition to IFRSs would be required to identify a fair value at an earlier date.

5. In September 2011, the Board concluded that an amendment should be made to IFRS 1 to require first time adopters to apply paragraph 10A of IAS 20 prospectively. It decided to amend IFRS 1 to add an exception to the retrospective application of IFRSs to require first-time adopters of IFRSs to apply the requirements in paragraph 10A of IAS 20 prospectively unless the information needed to apply these requirements to a government loan as a result of a past transaction was obtained at the time of initially accounting for that loan.

6. The Board published the exposure draft *Government Loans (Proposed amendment to IFRS 1)* in October 2011, with a 77 day comment period. The comment period ended on 5 January 2012. The comment letter analysis is presented below.

Comment analysis

Summary of the comments

7. 35 comment letters were received by the time the paper was drafted. Appendix A provides a breakdown of the demographic information of the respondents.

8. All the comment letters received supported the proposed amendment to IFRS 1. All comments received were considered by the staff, and those most relevant to the issue are discussed below.

Analysis of specific comments

9. Comments received have been categorised as follows:

   (a) the scope of the proposed amendment,

   (b) clarification on how to apply the exception after the date of transition,

   (c) clarification on whether the option to apply IFRS 9 retrospectively is available on a loan-by-loan basis, and

   (d) other comments:

      (i) optional exemption vs. mandatory exception, and

      (ii) request for the Board's future consideration of IFRS 1

The scope of the proposed amendment

10. Some respondents[1] raised concerns about the scope of the proposed amendment. A respondent noted that government loans may be accounted for directly as equity under some national GAAPs. The respondent argued that grandfathering such a practice would not result in information that is transparent for users or provide a suitable starting point for accounting in accordance with IFRS. Accordingly, the respondent thinks that the Board should limit the scope of the proposed transitional relief to entities that, under their previous GAAP, accounted for government loans as liabilities.

11. However, another respondent argued that the prospective provision should be applied regardless of the classifications of loans according to previous GAAP because an entity which accounted for the loans as equity according to previous GAAP also faces the difficulty and hindsight problem in measuring the fair value of those loans at a past date in a retrospective manner.

12. The staff think that draft paragraph B10 should be amended to limit the scope of the proposed exemption to matters of recognition and measurement. Limiting the relief to recognition and measurement would mean that a first-time adopter would be required to classify such a loan as a liability in accordance with IAS 32

[1] EFRAG; Korea Accounting Standards Board (KASB); Deloitte; BDO

Financial Instruments: Presentation, but would not be required to restate the carrying amount of the previous GAAP balance for the loan at the date of transition. This will give first-time adopters the same relief as existing preparers. This amendment will also make it clear that the Board does not mean to permit an entity not to apply IFRS 9 after the date of transition to such loans. Suggested drafting is as follows:

B10 A first-time adopter shall classify all loans received, including those from governments, as equity or liability in accordance with IAS 32 *Financial Instruments: Presentation.* Except as permitted by paragraph B11, a first-time adopter shall apply the requirements in IFRS 9 *Financial Instruments* that relate to measurement on initial recognition and paragraph 10A of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* prospectively to loans entered into on or after the date of transition to IFRSs. ~~For example~~Therefore, if a first-time adopter did not, under its previous GAAP, recognise and measure a government loan at a below-market rate of interest on a basis consistent with that required by IFRS 9, it shall not adjust its previous GAAP carrying amount at the date of transition for the loan ~~for~~in compliance with IFRS 9 and ~~paragraph 10A of~~ IAS 20 in this respect.

Question 1 for the Board
Does the Board agree with the staff's view that the amendment should be limited to matters of recognition and measurement?

Clarification on how to apply the exception after the date of transition

13. Two respondents[2] argue that it is not clear how an entity should subsequently account for a government loan at a below-market rate of interest entered into before the date of transition to IFRSs. The exposure draft proposes an exception to the recognition and measurement requirements in IFRS 9 and IAS 20 for such a loan at the date of transition to IFRSs.

14. The staff think that the intention of the Board is to require an entity to apply IFRS 9 after transition date to a government loan at a below-market rate of interest entered into before the date of transition to IFRSs. To apply IFRS 9 after the date of transition, the entity should calculate the effective interest rate by

[2] E&Y; Yoshinaga Yuko

comparing the carrying amount at the date of transition with the amount and timing of expected repayments to the government.

15. The staff recommend the following clarification be made to the wording of paragraph B10:

B10 Except as permitted by paragraph B11, a first-time adopter shall apply the requirements in IFRS 9 *Financial Instruments* and paragraph 10A of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* prospectively to loans entered into on or after the date of transition to IFRSs. For example, if a first-time adopter did not, under its previous GAAP, recognise and measure a government loan at a below-market rate of interest on a basis consistent with that required by IFRS 9, it shall not adjust its previous GAAP carrying amount at the date of transition for the loan for compliance with IFRS 9 and paragraph 10A of IAS 20. <u>An entity shall apply IFRS 9 to the subsequent measurement of such loans after transition date.</u>

16. We also think that it would be helpful to add an example as part of implementation guidance.

IG66 Paragraph B10 of the IFRS requires an entity not to adjust its previous GAAP carrying amount at the date of transition for a government loan entered into before the date of transition to IFRSs for compliance with IFRS 9 and paragraph 10A of IAS 20. Subsequently, the entity shall apply IFRS 9 to such a loan. To do so, the entity calculates the effective interest rate by comparing the carrying amount at the date of transition with the amount and timing of expected repayments to the government. Example 12 below illustrates accounting treatments for such a loan.

IG Example 12 Government loan at a below-market rate of interest entered into before the date of transition to IFRSs
To encourage entities to expand their operations in a specified development zone, where it is difficult for entities to obtain financing for their projects, the government provides loans at a below-market rate of interest to fund the purchase of manufacturing equipment. In accordance with the development scheme, an entity receives a loan at a below-market rate of interest from the government for CU100,000. Under the previous GAAP carrying amount is CU100,000 at the date of transition and the amount repayable will be CU103,030 three years later. There are no future performance conditions attached to the loans at a below-market rate of interest. In order to measure the loan at a below-market rate of interest after the date of transition of IFRSs, an effective interest rate can be calculated as below: = (103,030 / 100,000) ^ (⅓) – 1

= 0.01

Year	Carrying amount	Interest	Interest payable
0	100,000		
1	101,000	1,000	1,000
2	102,010	1,010	2,010
3	103,030	1,020	3,030

Question 2 for the Board

Does the Board agree with the staff's recommendation to include the example presented above to illustrate the accounting for the government loan in accordance with IFRS 9 for the date of transition?

Clarification on whether the option to apply IFRS 9 retrospectively is available on a loan-by-loan basis

17. Proposed paragraph B11 permits an entity to apply IFRS 9 retrospectively if the entity obtained the information needed to apply IFRS 9 at the relevant time. Some respondents[3] argued that the amendment should clarify whether or not the option is available on a loan-by-loan basis. The proposed amendments indicate that an entity that chooses to apply the proposed new paragraph B11 of IFRS 1 can apply the paragraph selectively on a loan-by-loan basis, rather than having to apply it to all government loans originated before the date of transition to IFRSs for which the information needed was obtained at the relevant time.

18. The staff think that prohibiting applying the option on a loan-by-loan basis will introduce further complexity in IFRS 1. This is because it may raise further questions such as whether the retrospective application would be permitted for all the loans for which the information needed was obtained at the time even if there are other similar loans for which the fair value information was not obtained at the time, or whether it should be restricted to some specific period

[3] EFRAG; E&Y; Dutch Accounting Standards Board (DASB); Securities & Exchange Board of India (SEBI); MAZARS; KPMG

before transition containing exclusively only government loans which can all be treated retrospectively[4].

19. We think that the exception in proposed paragraph B11 should be availble on a loan-by-loan basis for all government loans originated prior to the date of transition and for which the required information to apply IFRS 9 was obtained at the relevant time. Therefore, we recommend the following clarification be made to the wording of the exception:

B11 Despite paragraph B10, an entity may apply the requirements in IFRS 9 and paragraph 10A of IAS 20 retrospectively ~~from the date on which a government loan was originated~~ to any government loan originated prior to the date of transition to IFRSs, provided that the information needed to apply these requirements to that government loan was obtained at the time of initially accounting for that loan.

Question 3 for the Board
Does the Board agree with the staff's view that the option of retrospective application, when the information needed can be obtained, should be available on loan-by-loan basis?

Other comments

Optional exemption vs. mandatory exception

20. Two respondents[5] argue that the prospective application may decrease the relevance of the information presented by an entity because an entity may account for two similar loans in different ways (for example, a government loan granted before the date of IFRS adoption and another loan after that date). Accordingly, they suggest that the requirement is treated as an optional exemption rather than a mandatory exception.

21. We think that the Board considered this issue, when it finalised the exposure draft, and concluded that the amendments should be a mandatory exception to

[4] MAZARS
[5] Group of Latin American Accounting Standard setters(GLASS); Federacion Argentina de Consejos Profesionales de Ciencias Económicas

prevent an entity from applying hindsight if it must derive a fair value that needs significant unobservable inputs.

22. On the other hand, two respondents[6] asked why the retrospective application of IAS 20 should be optional *if the information needed to apply IFRS 9 had been obtained*. We think that if restatement is a requirement for past loans, where fair value information was obtained at the inception of such loans, this could place an onerous requirement on the entity to search for this information in circumstances where the loan was received many years ago.

Request for the Board's future consideration of IFRS 1

23. Two respondents[7] suggest that the Board consider applying this relief to other changes made to IFRS, and for which prospective application was permitted at the time. For example, the requirement to measure at fair value an entity's investment property under construction was applied prospectively, in accordance with paragraph 85B of IAS 40. One of the respondents suggests adding an additional exception for first-time adopters from some of the requirements in IAS 28 *Investments in Associates and Joint Ventures*.

24. A respondent[8] argues that a general "impracticability" relief such as the guidance in paragraphs 50 to 53 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* is not included in IFRS 1. Therefore, new or amended standards may lead to complexity in IFRS 1 as well as leaving other situations of impracticability unaddressed. It is suggested that the Board consider whether, as a matter of principle, the impracticability guidance in paragraphs 50 to 53 of IAS 8 should be included in IFRS 1 as a generally available exception from restatement.

25. We think that these issues are beyond the scope of the amendment. However we recommend that the Board considers whether a revision of IFRS 1 is needed as part of its consideration of its future agenda and feedback received to the Request for Views.

[6] EFRAG; Hong Kong Institute of Certified Public Accountants
[7] ACCA; Yoshinaga Yuko
[8] Hong Kong Institute of Certified Public Accountants

Question 4 for the Board
Does the Board agree with the staff's view that no changes to the amendment are required in respect of the other comments discussed above?

Staff recommendation

Effective date

26. The staff recommend that the final amendment be effective for reporting periods beginning on or after 1 January 2013. The staff also recommend that earlier adoption is permitted as proposed in the exposure draft.

Next steps

27. Subject to discussions at the Board meeting, the staff will prepare a ballot draft taking the Board's comments into account, with the objective of issuing the amendment by mid-February 2012. This will assist those entities wishing to apply the amendment in their 2011 financial statements.

Question 5 for the Board
5(a) Does the Board have anything further to add with respect to the comments received on this exposure draft? 5(b) Does the Board have any comments on the proposed wording for the amendments to IFRS 1 in Appendices B and C? 5(c) Does the Board approve the staff to proceed with this proposed amendment including finalisation of drafting and a ballot to be provided to the Board for finalisation of this project?

Appendix A – Demographic information of respondents

A1. This Appendix provides demographic information on the respondents to the exposure draft *Government Loans* published in October 2011. The table below contains details of the respondents to the exposure draft, who submitted comment letters by 5 January 2012, categorised by type and geography. 35 comment letters were received in total.

CL#	Respondent	Respondent Type	Geography
1	Yuko Yoshinaga	Other/Individual	Japan
2	DRSC e.V.(German Accounting Standards Board)	Standard Setter	Germany
3	Zambia Institute of Chartered Accountants (ZICA)	Standard Setter	Zambia
4	Ernst & Young EYGS LLP	Accounting Firm	Global
5	Australian Accounting Standards Board	Standard Setter	Australia
6	Canadian Accounting Standards Board	Standard Setter	Canada
7	Deloitte Touche Tohmatsu Limited	Accounting Firm	Global
8	Accounting Standards Board	Standard Setter	United Kingdom
9	CPA Ireland	Standard Setter	Ireland
10	Grant Thornton International Ltd	Accounting Firm	Global
11	CINIF	Standard Setter	Mexico
12	Japan Foreign Trade Council, Inc.	Preparer	Japan
13	SAICA	Standard Setter	South Africa
14	Federacion Argentina de Consejos Profesionales de Ciencias Económicas	Standard Setter	Argentina
15	Dutch Accounting Standards Board (DASB)	Standard Setter	Netherlands
16	Enmax Corporation	Preparer	Canada
17	Accounting Standards Council	Standard Setter	Singapore
18	Hong Kong Institute of Certified Public Accountants	Standard Setter	Hong Kong
19	Korea Accounting Standards Board (KASB)	Standard Setter	Korea
20	Institute of Chartered Accountants of India (ICAI)	Standard Setter	India
21	Larsen & Toubro Limited	Preparer	India
22	RSM International	Accounting Firm	United Kingdom
23	SEBI (Securities & Exchange Board of India)	Regulator	India
24	CIPFA	Accountancy body	United Kingdom
25	Glass-Group of Latin American Accounting Standard Setters	Standard Setter	Latin America
26	ACCA	Accountancy body	United Kingdom
27	Mazars	Accounting Firm	France
28	KPMG	Accounting Firm	Global
29	Institute of Certified Public Accountants of Rwanda (ICPAR)	Standard Setter	Rwanda
30	Norsk Regnskapsstiftelse (The Norwegian Accounting Standards Board)	Standard Setter	Norway
31	BDO IFR Advisory Limited	Accounting Firm	Global
32	Malaysian Accounting Standards Board (MASB)	Standard Setter	Malaysia
33	ICAEW	Accountancy body	United Kingdom
34	Institute of Certified Public Accountants of Singapore	Accountancy body	Singapore
35	EFRAG	Standard Setter	Europe

Appendix B – Draft wording of the final amendment as compared to the current version of IFRS 1

B1. The staff proposes draft wording for the final amendment. This Appendix shows the proposed draft wording **as compared to the current version of IFRS 1.** Proposed changes from the current standard are shown as follows: new text is underlined and deleted text is struck through.

B2. All Board edits/comments are appreciated in preparation for the final amendment balloting.

Amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Paragraphs 39N and 39O are added and B1 is amended. After paragraph B9 a heading and paragraph B10 and B11 are added.

<u>39N</u> <u>*Government Loans* (Amendments to IFRS 1), issued [Month, year] added paragraphs B1(f), B10 and B11. An entity shall apply those paragraphs for annual periods beginning on or after 1 January 2013. Earlier application is permitted.</u>

<u>39O</u> <u>Paragraphs B10 and B11 refer to IFRS 9. If an entity applies this IFRS but does not yet apply IFRS 9, the references in paragraphs B10 and B11 to IFRS 9 shall be read as references to IAS 39 *Financial Instruments: Recognition and Measurement.*</u>

B1 An entity shall apply the following exceptions:

(a) derecognition of financial assets and financial liabilities (paragraphs B2 and B3);

(b) hedge accounting (paragraphs B4–B6);

(c) non-controlling interests (paragraph B7);

(d) classification and measurement of financial assets (paragraph B8); ~~and~~

(e) embedded derivatives (paragraph B9)~~.~~<u>; and</u>

(f) government loans (paragraphs B10 and B11).

Government loans

B10 A first-time adopter shall classify all loans received, including those from governments, as equity or liability in accordance with IAS 32 *Financial Instruments: Presentation*. Except as permitted by paragraph B11, a first-time adopter shall apply the requirements in IFRS 9 *Financial Instruments* that relate to measurement on initial recognition and paragraph 10A of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* prospectively to loans entered into on or after the date of transition to IFRSs. Therefore, if a first-time adopter did not, under its previous GAAP, recognise and measure a government loan at a below-market rate of interest on a basis consistent with that required by IFRS 9, it shall not adjust its previous GAAP carrying amount at the date of transition for the loan in compliance with IFRS 9 and IAS 20 in this respect. An entity shall apply IFRS 9 to the subsequent measurement of such loans after transition date.

B11 Despite paragraph B10, an entity may apply the requirements in IFRS 9 and paragraph 10A of IAS 20 retrospectively to any government loan originated prior to the date of transition to IFRSs, provided that the information needed to apply these requirements to that government loan was obtained at the time of initially accounting for that loan.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the proposed amendments.

Paragraph BC74 is amended.

Retrospective designation

BC74 The Board considered practical implementation difficulties that could arise from the retrospective application of aspects of IAS 39:

(a) hedge accounting (paragraphs BC75–BC80);

(b) government loans (paragraphs BC80A–BC80D);

(~~b~~c) the treatment of cumulative fair value changes on available-for-sale financial assets at the date of transition to IFRSs (paragraphs BC81–BC83); and

(~~c~~d) 'day 1' gain or loss recognition (paragraph BC83A).

After paragraph BC80, a heading and paragraphs BC80A–BC80D are added.

Government loans

BC80A IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* (as revised in May 2008) contains a requirement that government loans with a below-market rate of interest be measured at fair value on initial recognition. When this requirement was added to IAS 20 in May 2008, the Board recognised that applying this requirement retrospectively may require entities to measure the fair value of loans at an earlier date. Accordingly the Board decided that this requirement in IAS 20 be applied prospectively.

BC80B In August 2011 the application of this requirement by first-time adopters of IFRSs was brought to the Board's attention. The Board noted that the general requirement in IFRS 1 for first-time adopters to apply IFRSs retrospectively at the date of transition could require some entities to measure government loans with a below-market rate of interest at fair value from a date prior to the date of transition. This may lead to an entity applying hindsight if it must derive a fair value that needs significant unobservable inputs. Accordingly the Board decided to add an exception to the retrospective application of IFRSs to require that first-time adopters of IFRSs apply the requirements in paragraph 10A of IAS 20 prospectively to loans entered into on or after the date of transition to IFRSs, unless the information needed to apply these requirements to a government loan as a result of a past transaction was obtained at the time of initially accounting for that loan.

BC80C The Board decided that paragraph B10 should limit the scope of the exemption to matters of recognition and measurement. This will give first-time adopters the same relief as existing preparers because government loans accounted for as equity under previous GAAP should be reclassified as liabilities, however such an entity should not adjust its previous GAAP carrying amount at the date of transition. This amendment also makes it clear that an entity should apply IFRS 9 to such loans after the date of transition.

BC80D Some commentators of the exposure draft asked why the retrospective application of IAS 20 should be optional if the information needed to apply IFRS 9 had been obtained. The Board thought that if restatement is a requirement for past loans, where fair value information was obtained at the inception of such loans, this could place an onerous requirement on the entity to search for this information in circumstances where the loan was received many years ago.

Guidance on implementing

This guidance accompanies, but is not part of, IFRS 1.

A heading, paragraphs IG 66 and Example 12 are added.

IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*

IG66 Paragraph B10 of the IFRS requires an entity not to adjust its previous GAAP carrying amount at the date of transition for a government loan entered into before the date of transition to IFRSs for compliance with IFRS 9 and paragraph 10A of IAS 20. Subsequently, the entity shall apply IFRS 9 to such a loan. To do so, the entity calculates the effective interest rate by comparing the carrying amount at the date of transition with the amount and timing of expected repayments to the government. Example 12 below illustrates accounting treatments for such a loan.

IG Example 12 Government loan at a below-market rate of interest entered into before the date of transition to IFRSs

To encourage entities to expand their operations in a specified development zone, where it is difficult for entities to obtain financing for their projects, the government provides loans at a below-market rate of interest to fund the purchase of manufacturing equipment.

In accordance with the development scheme, an entity receives a loan at a below-market rate of interest from the government for CU100,000. Under the previous GAAP carrying amount is CU100,000 at the date of transition and the amount repayable will be CU103,030 three years later.

There are no future performance conditions attached to the loans at a below-market rate of interest.

In order to measure the loan at a below-market rate of interest after the date of transition of IFRSs, an effective interest rate can be calculated as below:

= (103,030 / 100,000) ^ (⅓) – 1

= 0.01

Year	Carrying amount	Interest	Interest payable
0	100,000		
1	101,000	1,000	1,000
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Appendix C – Draft wording of the final amendment as compared to the exposure draft *Government Loans* (Proposed amendment to IFRS 1)

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C2 All Board edits/comments are appreciated in preparation for the final amendment balloting.

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(c) non-controlling interests (paragraph B7);

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BC~~2~~80B In August 2011 the application of this requirement by first-time adopters of IFRSs was brought to the Board's attention. The Board noted that the general requirement in IFRS 1 for first-time adopters to apply IFRSs retrospectively at the date of transition could require some entities to measure government loans with a below-market rate of interest at fair value from a date prior to the date of transition. This may lead to an entity applying hindsight if it must derive a fair value that needs significant unobservable inputs. Accordingly the Board ~~is proposing~~decided to add an exception to the retrospective application of IFRSs to require that first-time adopters of IFRSs apply the requirements in paragraph 10A of IAS 20 prospectively to loans entered into on or after the date of transition to IFRSs, unless the information needed to apply these requirements to a government loan as a result of a past transaction was obtained at the time of initially accounting for that loan.

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