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Transactions other than Exchanges of Equal Value Cover Note and Project Update

Objective of the session

- 1 The objective of this session is to discuss and obtain EFRAG TEG's views on:
 - (a) the revised scope of the research project on Transactions other than Exchanges of Equal Value (TEEV); and
 - (b) the comprehensive accounting model being developed for Transactions other than Exchanges of Equal Value.

Background of the project

Objective of the project

- 2 During the IASB 2016 Agenda Consultation, some constituents identified non-reciprocal transactions as an area requiring attention by the IASB. These constituents identified several different transactions, including income taxes, levies, pollutant pricing mechanisms and government grants as examples of transactions in which the non-reciprocal nature of the transactions contributed to the difficulties in accounting for them. They noted that these transactions may have characteristics that could warrant a specific accounting treatment.
- 3 The IASB finally decided to not add this project to its agenda as it was not persuaded that grouping these topics would allow to find a common solution.
- 4 In March 2016, after the completion of the EFRAG Proactive Agenda consultation, the EFRAG Board approved to add to the agenda a research project on non-reciprocal transactions. The objective of the project is to consider whether the characteristics of certain transactions may justify a different accounting approach.

Scope of the project

- 5 The scope of the project has been revised to include transactions other than exchanges of equal value which do not observe the arm's length principle and can be both voluntary and non-voluntary transactions. The nature of such transactions includes a wider objective to provide social benefits to individuals, households or society as a whole.
- 6 The EFRAG Secretariat is suggesting that scope of the TEEV project explicitly excludes transaction within the scope of the IASB project on Rate-regulated Activities as currently defined by the IASB. EFRAG Secretariat will assess in future to what extent the two models are consistent and could be aligned.
- 7 Furthermore, the EFRAG Secretariat is also suggesting to exclude transactions between an entity and its majority shareholders in their capacity as such.

Past discussions of EFRAG TEG

EFRAG TEG meeting – September 2016

- 8 EFRAG TEG discussed how the example of levies could be used as a lead-in to start developing an accounting model for transactions with the characteristics described in paragraph 5, above. It was noted that:
- (a) the forced nature of a transaction such as levies may justify a change in the timing of the recognition. When the entity does not have full discretion to avoid the outflow of resources, recognition of a future likely transaction does not create the risk of a future reversal (at least, not a reversal contingent only on the entity's decisions).
 - (b) the non-reciprocal nature of a transaction may justify a change in the way the cost of a transaction is allocated. Normally, cost is allocated to depict the consumption of the benefits from a transaction, although it may also reflect the reassessment of previously expected benefits (impairment). If the entity does not receive goods or services, or is unable to identify them, then a different approach to cost allocation is needed.
- 9 EFRAG TEG generally agreed that, as a starting point, EFRAG Secretariat could look again at the accounting for levies, and develop a conceptual justification for the alternative accounting. However, the research should not be limited to considering whether such transactions create assets and liabilities as defined in the *Conceptual Framework* but should also consider the issue from the perspective of depiction of the performance.

EFRAG TEG meeting - December 2016

- 10 EFRAG TEG discussed a possible conceptual approach for expense-generating transactions in the scope of the project using the example of levies as a lead-in.
- 11 The approach considered that, for certain types of levies, a straight-line allocation of cost could be justified on the basis of a receiving 'general benefits' from the general activities of Government (such as Educations, Healthcare etc.). EFRAG TEG discussed a paper comparing the application of the current *Conceptual Framework*, the revised *Conceptual Framework* and the proposed alternative approach to a number of expense transactions.
- 12 The imposed nature of transactions such as levies was used as a rationale to anticipate the recognition of a liability compared to the general definition on the basis that the imposed nature would make any reversal unlikely to happen. This was also used as a rationale for a straight-line recognition of expenses (in the case of recurring payments) as it seemed reasonable to assume, in the absence of other determinable consumption patterns, that services rendered by Government were consumed continuously.
- 13 EFRAG TEG tentatively agreed that for most recurring levies, progressive recognition of cost was the appropriate answer. A possible conceptual basis is that the entity may be receiving some indirect benefit from the general activities of the Government, although there is no direct link between the amount paid and the benefit received;
- 14 It was noted that, the progressive recognition may result for some levies in the recognition of balances that do not meet the current definition of liability under the *Conceptual Framework for Financial Reporting*. It was unclear if the proposed amendments to the definition would eliminate the conflict.
- 15 EFRAG TEG generally agreed with the broad direction of the paper and suggested the following improvements for future development of the research:

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- (a) to better articulate how the characteristics of the transactions in the scope of the project justify a different approach and in the ‘causal links’ that may exist between a payment made and an underlying transaction; and
- (b) to consider whether the possible approach could be useful in accounting for a wider range of arrangements than levies, in particular for income-generating transactions such as government grants.

EFRAG TEG meeting - February 2017

- 16 EFRAG TEG considered a paper that used government grants as a lead to illustrate how the model could also apply to revenue generating transactions, and the related challenges.
- 17 It was noted from the outset that the ‘imposed transaction’ criterion previously used to define the scope of the project would need to be reconsidered. One way to maintain the criterion in the model would be to consider the degree of discretion from the perspective of the grantor. Sometimes, laws and regulations create an obligation on the Government to provide the assistance, provided that some conditions are met. The obligation is therefore not seen from the perspective of the individual beneficiary – that does not have an enforceable claim to resources; but from the perspective of the general public interest.
- 18 The EFRAG Secretariat was asked to reconsider, at a future meeting, the implication of removing the ‘imposed’ criterion for the expense-generating transactions model (i.e only scoping criterion would be the lack of evidence of an exchange of equal value).
- 19 The model also suggested to consider whether conditions attached to certain grants and similar government assistance could create forms of ‘performance obligations’ that could be considered as the basis for the income recognition. EFRAG TEG suggested that further analyse of the concepts in IFRS 15 *Revenue from Contracts with Customers* would be useful in developing the income model further, subject to modification, if necessary. In particular, it was suggested to:
 - (a) better analyse the effects of ‘conditions’ stipulated in government grant and similar agreements i.e. distinguish whether these conditions actually have economic consequences and create obligations for the beneficiaries and when they can be considered to be satisfied; and
 - (b) more broadly, look at the principles and concepts in existing IFRSs to see if they can provide a framework for some of the transactions under consideration.

EFRAG TEG meeting - July 2017

- 20 In July 2017, EFRAG TEG members discussed the scope of the research project and in particular whether the ‘imposed transaction’ criterion should be retained. Furthermore, they discussed whether and how a performance obligation approach could be applied to some forms of income-generating transaction considered in the research.
- 21 EFRAG TEG members suggested that the scope of the TEEV research project should include both expense and income-generating transactions but should not be defined too broadly.
- 22 Some EFRAG TEG members considered that the notion of ‘equal value’ could create complexity (in defining and measuring ‘value’). They preferred to base the scope of the project on the economic characteristics of a class of transactions. In their view, the non-reciprocal or unequal value features could be used as indicators to characterise such transactions but not as a primary scope determinant.

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- 23 In addition, suggestions were made to limit the project scope to a more specific subset of transactions such as levies and grants as a narrow focused research scope would be more likely to succeed.
- 24 With respect to the application of a performance obligation approach to some forms of income-generating transaction, some EFRAG TEG members generally agreed that some of the principles in IFRS 15 could be helpful and suggested that EFRAG Secretariat should explore how those principles could be adapted to address a broader set of transactions covered in the research. Nevertheless, the research should also try and address situations where no form of performance obligation can be identified.

Future steps

- 25 For the next sessions of the project, the EFRAG Secretariat plans to address the following:
- (a) to address potential issues related to measurement that had been identified on the first phase of the project, where the focus was in the recognition aspects. This could apply to transactions such as defence / security contracts, bank bailouts, etc.
 - (b) to consider the issue of disclosures.

Planned final outcome

- 26 The expected output of the project would be a short discussion paper, assuming that EFRAG is able to identify some potential alternatives to present to constituents. The discussion paper could be useful in providing input to the EFRAG's comments to the IASB revised *Conceptual Framework*.

Questions for EFRAG TEG

- 27 Does EFRAG TEG have comments on the project update?

Agenda Papers

- 28 In addition to this cover note, agenda paper 02-02 – *Issues Paper on TEEV Research Project – Revised approach* – has been provided for the session.