EFRAG Secretariat: Filippo Poli,
Hocine Kebli, Ioana Kiss

Transfers other than Exchanges of Equal Value (ToEEV) Cover Note

Objective of the session

1 The objective of this session is to:

(a) confirm that all the comments and suggestions from EFRAG TEG have been appropriately addressed in the revised draft of the discussion paper (DP);

(b) agree to recommend the discussion paper to the EFRAG Board for publication.

Background of the project

Objective of the project

2 During the IASB 2016 Agenda Consultation, some constituents identified non-reciprocal transfers as an area requiring attention by the IASB. These constituents identified several different transfers, including income taxes, levies, and government grants as examples of transfers in which the non-reciprocal nature of the transfers contributed to the difficulties in accounting for them. They noted that these transfers 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 transfers. The objective of the project is to consider whether the characteristics of certain transfers may justify a different accounting approach.

Scope of the project

5 The scope of the project is described in Chapter 2 of the draft discussion paper and has been discussed several times with EFRAG TEG. The nature of such transfers may include a wider objective to provide social benefits to individuals, households or society as a whole.

6 The EFRAG Secretariat is suggesting that scope explicitly excludes transfers within the scope of the IASB project on Rate-regulated Activities and income taxes as currently defined. The EFRAG Secretariat is also suggesting excluding transfers between an entity and its majority shareholders in their capacity as such. The reasons for the proposed exclusions are provided in the paper.

Past discussions of EFRAG TEG

April 2018

7 At its April meeting, EFRAG TEG discussed the initial drafting of some of the sections of the Discussion Paper (Chapters 1 to 4 and Appendix 1) and generally reiterated their support for the proposed approach. The following suggestions were made to improve the drafting:

(a) ensure clarity and consistent use of terms;

(b) improve the explanations regarding the scope exception for income taxes;

(c) clarify the description of Step 2 and the meaning of 'recurring' in Step 3 of the model; and

(d) provide a more comprehensive comparison of the model with the revised *Conceptual Framework*.

November 2017

8 EFRAG TEG members generally supported the proposed scope and the general direction of the project. However, suggestions were made to clarify what type of transfers would not fall in the scope:

9 Suggestions included:

(a) Limit the scope by explicitly excluding transfers with shareholders in their capacity as such and transfers within the scope of the rate-regulated activities project. However, EFRAG TEG members had mixed views about the exclusion of income taxes from the scope.

(b) Use more consistent wording when defining the different steps in the accounting model for ToEEV transfers. Suggestion was made to replace 'performance obligation' with 'performance condition' as it better fitted the substance of the transfers.

(c) Clarify the wording around transfers 'linked to an underlying exchange'. However, members supported the concept and its articulation in the overall proposed approach.

(d) Include more illustrative examples.

July 2017

10 In July 2017, EFRAG TEG members discussed the scope of the research project and in particular whether the 'imposed transfer' criterion should be retained. Furthermore, they discussed whether and how a performance obligation approach could be applied to some forms of income-generating transfer considered in the research.

11 EFRAG TEG members suggested that the scope of the ToEEV research project should include both expense and income-generating transfers but should not be defined too broadly.

12 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 transfers. In their view, the non-reciprocal or unequal value features could be used as indicators to characterise such transfers but not as a primary scope determinant.

13 In addition, suggestions were made to limit the project scope to a more specific subset of transfers such as levies and grants as a narrow-focused research scope would be more likely to succeed.

14 With respect to the application of a performance obligation approach to some forms of income-generating transfer, 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 transfers covered in the research. Nevertheless, the research should also try and address situations where no form of performance obligation can be identified.

February 2017

15 EFRAG TEG considered a paper that used government grants as a lead to illustrate how the model could also apply to revenue generating transfers, and the related challenges.

16 It was noted form the outset that the ‘imposed transfer’ 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.

17 The EFRAG Secretariat was asked to reconsider, at a future meeting, the implication of removing the ‘imposed’ criterion for the expense-generating transfers model (i.e. only scoping criterion would be the lack of evidence of an exchange of equal value).

18 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 transfers under consideration.

December 2016

19 EFRAG TEG discussed a possible conceptual approach for expense-generating transfers in the scope of the project using the example of levies as a lead-in.

20 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 transfers.

21 The imposed nature of transfers 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.

22 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;

23 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.

24 EFRAG TEG generally agreed with the broad direction of the paper and suggested the following improvements for future development of the research:

(a) to better articulate how the characteristics of the transfers 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 transfer; 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 transfers such as government grants.

September 2016

25 EFRAG TEG discussed how levies could be used to develop an accounting model for transfers within the proposed scope. It was noted that:

(a) the forced nature of a transfer 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 transfer 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 transfer may justify a change in the way the cost of a transfer is allocated. Normally, cost is allocated to depict the consumption of the benefits from a transfer, 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.

26 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 transfers create assets and liabilities as defined in the *Conceptual Framework* but should also consider the issue from the perspective of depiction of the performance.

Question for EFRAG TEG

27 Does EFRAG TEG agree that their suggestions and recommendations have been adequately reflected in the drafting of the DP and the illustrative examples?

Agenda Papers

28 In addition to this cover note, agenda papers for this session are:

(a) Agenda paper 10-02a – *Issues Paper on ToEEV Research Paper Transfers other than Exchange of Equal Value* – clean version of the DP; and

(b) Agenda paper 10-02b – *Issues Paper on ToEEV Research Paper Transfers other than Exchange of Equal Value* – mark-up version of the DP;