EFRAG

European Financial Reporting Advisory Group

FEEDBACK STATEMENT

Responses to EFRAG Short Discussion Series Paper

Levies: what would have to be changed in IFRS for a different accounting outcome?

This feedback statement has been prepared by the EFRAG staff for the convenience of constituents and represents a summary of responses received to the EFRAG Short Discussion Series Paper. It does not represent an expression of the views of EFRAG.

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Introduction

The EFRAG Short Discussion Series addresses topical and problematic issues with the aim of helping the IASB to address cross-cutting dilemmas in financial reporting and stimulating debate among European constituents and beyond.

Levies: what would have to be changed in IFRS for a different accounting outcome? ('the EFRAG SDS Paper' or 'the paper') was published on 14 August 2014. Comments were requested by 15 December 2014.

Why was the paper written?

In 2014 the European Commission endorsed IFRIC 21 *Levies.* The Interpretation addresses the timing of recognition of a liability to pay a levy stating that a liability is recognised when the obligating event identified by the law occurs. The consensus of IFRIC 21 was based on the definition of a liability in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and the Conceptual Framework.

Combined with the requirements in IAS 38 *Intangible Assets*, IFRIC 21 will often result in the immediate expensing of levies charged on an annual basis, when the law indicates an activity that occurs at a point-in-time. Some have expressed concern with this outcome because they believe that the cost of a levy charged on an annual basis should be recognised over the annual period it refers to. They believe the economic substance of a recurring levy is that the entity is paying to operate over an annual period, although the law may identify a different activity that triggers the payment (such as being in operation at a certain date). Based on this, some have claimed that the EU should call for a revision of the principles in IAS 37.

The aim of this paper was to:

- revisit the main changes proposed in the IAS 37 amendment project to assess if they would be relevant in considering whether to modify the consensus in IFRIC 21 to address the concerns expressed by European constituents; and
- illustrate alternative approaches that would affect the accounting outcome that some constituents are concerned about (the immediate charge to profit and loss of recurring levies when the law indicates a point-in-time obligating event).

It was not the purpose of the paper to reach a conclusion on the best accounting treatment for levies but to investigate different alternatives to address the concerns expressed by European constituents.

Recent developments on the issue

Since the publication of the EFRAG SDS Paper, the IASB has continued working on the definition and recognition criteria for liabilities in its current project on the Conceptual Framework.

In July 2014[1] the IASB discussed the meaning of present obligation and tentatively decided that an entity has a present obligation to transfer an economic resource as a result of past events if both:

(a) the entity has no practical ability to avoid the transfer; and

[1] For detailed information see http://www.ifrs.org/Current-Projects/IASB-Projects/Conceptual-Framework/Documents/Effect-of-Board-decisions-DP-November-2014.pdf.

(b) the amount of the transfer is determined by reference to benefits that the entity has received, or activities that it has conducted, in the past.

The IASB tentatively decided that the Conceptual Framework should include, among others, the following general guidance:

- In the absence of legal enforceability, an entity has no practical ability to avoid transferring an economic resource if it has a constructive obligation.
- In some situations, an entity might be required to transfer an economic resource if it takes a particular course of action in the future, such as conducting particular activities. In such situations, if the entity has no practical ability to avoid the particular course of action that would require the transfer and the other criterion is also met, the entity has a present obligation.
- Situations in which an entity has no practical ability to avoid a particular course of action include those in which all courses of action that avoid the transfer would cause significant business disruption or have economic consequences significantly more adverse than the transfer itself.
- An entity that prepares financial statements on a going concern basis has no practical ability to avoid a transfer that could be avoided only by liquidating the entity or ceasing trading.

In addition, the Interpretations Committee was asked to provide guidance on how to account for the debit side of levies raised on production property, plant and equipment. The Interpretations Committee considered whether such costs should be recognised as an expense, a prepaid expense or as an asset in accordance with IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment* or IAS 38. Based on its previous discussions held at the time when IFRIC 21 was developed, the Interpretations Committee decided not to provide guidance on this matter. The Interpretations Committee noted that IFRIC 21 is an Interpretation of IAS 37 and that paragraph 8 of IAS 37 states that IAS 37 does not deal with the recognition of either the asset or expense associated with a liability. Entities instead should apply other Standards to decide whether the recognition of a liability to pay a levy gives rise to an asset or to an expense. It also noted that it would not be efficient to give case-by-case guidance based on the fact patterns of individual levies. Therefore, the Interpretations Committee decided not to add this issue to its agenda[2].

Responses from constituents

Seven comment letters were received in response to the EFRAG SDS Paper. A list of respondents is in the Appendix to this feedback statement. All comment letters received are available on the project page for the EFRAG SDS Paper on the EFRAG website.

Profile of responses by origin and type of respondent

By country/region of respondent		By type of respondent	
France	3	National Standard Setter	4
Norway	1	Preparer Association	1
Spain	1	Preparer	1
The Netherlands	1	Business Association	1
European Organisation	1		

[2] http://media.ifrs.org/2015/IFRIC/January/IFRIC-Update-January-2015.pdf

Purpose and use of this feedback statement

This feedback statement has been prepared as a formal record of the responses received. It will be used by EFRAG as input for any future work on levies. It summarises the messages received from constituents and notes any key themes identified.

This feedback statement should be read in conjunction with the EFRAG SDS Paper, which is available on the EFRAG website.

Questions asked in the EFRAG SDS Paper

The EFRAG SDS Paper asked eight questions to constituents:

Q1 Do you have concerns that the application of IFRIC 21 and other relevant Standards may sometimes result in inappropriate outcomes (such as charging immediately to profit or loss the cost of a levy that should be instead recognised over a period)?

Q2 Based on the existing applicable Standards, do you think that entities will be able in practice to identify assets or services received in exchange for levies?

Q3 Is the proposed guidance in paragraph 62 helpful in this respect? And, should the guidance also include criteria to distinguish if an entity has received an asset rather than a service (or vice versa)?

Q4 For those levies where the law indicates a point-in-time obligation, do you agree that there may be other elements in the law to designate the obligating event? If so, do you agree with the elements described in paragraphs 65 to 68?

Q5 In which cases, if any, a levy measured on a balance sheet figure can be linked to an activity performed over time, and therefore there is a conceptual basis to recognise it over time? (see paragraphs 56 and 74)

Q6 Do you agree with the inclusion of a specific requirement in IAS 34 *Interim Financial Reporting* as a short term solution?

Q7 Do you agree that the IASB should add to its agenda a Research project to deal with transactions with Government authorities in their capacity as authorities?

Q8 Do you think that other different alternatives could be explored in the paper in order to reach a different outcome when accounting for levies?

Summary and key messages

Responses to the paper showed that, in general, respondents are concerned with the application of IFRIC 21 since they believe that, especially in interim periods, entities' performance will be distorted as the cost of certain levies charged on a periodic basis will be recognised at a point in time.

In general, respondents believed that it will be difficult to identify assets or services in exchange for the payment of levies. Respondents noted that such assessment required a case-by-case analysis. Nevertheless, they did not indicate additional characteristics of levies that might be assessed for analysing whether assets or services were received in exchange for its payment beyond those proposed in the paper.

Overall, respondents agreed that there might be elements in the law to designate the obligating event other than the due date specified in the law. In particular, some respondents considered that the characteristic described in paragraph 67 of the paper (levy proportionately reduced based on the number of days in which the entity was in business during a period) was a good indicator that the levy should be recognised over a period.

Respondents would support the IASB developing a research project dealing with all transactions with government authorities. However, in general, respondents believed that other alternatives would provide a better solution. Specifically, respondents preferred the inclusion of a specific requirement in IAS 34 *Interim Financial Reporting* as the most effective in terms of practicality, ease and speed of implementation. One respondent that favoured developing specific requirements in IAS 34 noted that they would not support a full revision of the principles in IAS 37 for the sole purpose of solving a specific issue relating to levies. A minority was not however in favour of short term solutions and pointed to IAS 12 *Income Taxes* principles as a better solution.

Analysis of responses

Question 1

Do you have concerns that the application of IFRIC 21 and other relevant Standards may sometimes result in inappropriate outcomes (such as charging immediately to profit or loss the cost of a levy that should be instead recognised over a period)?

All respondents answered this question.

Six respondents believed that the application of IFRIC 21 will lead (sometimes or frequently) to inappropriate outcomes.

One respondent[3] was not concerned that the application of IFRIC 21 might result in inappropriate accounting outcomes. Although it welcomed EFRAG's initiative, in its view, IFRIC 21 meets the principles set out in the current *Conceptual Framework for Financial Reporting*. It noted that, in IFRIC 21 examples, the liability is recognised according to the definition of liabilities in IAS 37 and, therefore, a different recognition criterion would require a different definition of liabilities. The respondent highlighted two consequences of the alternative definition of liabilities assessed in paragraph 53 of the paper:

(a) Any change to the definition and recognition criteria in the Conceptual Framework would apply to all liabilities; and

[3] ICAC.

(b) The proposed definition draws from the principle of prudence in the recognition of expenses.

One respondent[4], despite expressing some concerns about the inappropriate outcome of IFRIC 21 in some situations, noted that this, in itself, did not warrant a full revision of the principles in IAS 37.

Question 2

Based on the existing applicable Standards, do you think that entities will be able in practice to identify assets or services received in exchange for levies?

All respondents answered the question. Overall respondents agreed that it will be difficult to identify assets or services received in exchange for the payment of a levy.

One respondent[5] believed that it would not be possible to develop a principle applicable to all levies. In its view it would be possible that some levies were recognised as assets but it would require a case-by-case analysis.

One respondent[6] considered that the key aspect of IFRIC 21 was whether the debit entry was recognised in the income statement or in the balance sheet. The respondent agreed that it would be difficult to identify assets or services and, therefore, suggested developing further guidance to help in such identification.

One respondent[7] noted that in some situations entities would be able to identify assets or services. In its view, it might occur when the levy was of the nature of a "license to operate" and failure to pay resulted in the loss of that right (paragraph 62(d) of the paper) and when the entity could benefit directly or indirectly from the payment of the levy (paragraph 62(a) of the paper).

One respondent[8] believed it was possible to identify assets or services in practice but it might be difficult to meet the recognition criteria because the definition of assets required that an entity had control over the resource. In its view, it was difficult for an entity to argue that it controls the activities performed by the government in relation to the levy and the future economic benefits related to the levy.

One respondent[9] noted that in many jurisdictions levies were intended to fund annual public budgets which were thereafter redistributed in public services which entities could directly benefit. However, it noted that in most cases there were no direct linkage between the amount of the levy paid and the economic benefits received in exchange. It noted as well that defining whether an entity received an asset required a high level of judgment which could result in diversity in practice.

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[4] Norwegian Accounting Standards Board.

[5] ACTEO/AFEP/MEDEF.

[6] Norwegian Accounting Standards Board.

[7] Business Europe.

[8] Dutch Accounting Standard Board.

[9] ANC.

Question 3

> Is the proposed guidance in paragraph 62 helpful in this respect? And, should the guidance also include criteria to distinguish if an entity has received an asset rather than a service (or vice versa)?

Four respondents[10] answered the first part of the question. Only one respondent answered the second part of the question.

One respondent[11] explained that most of the levies funded the general budget of the country or of the local authorities and since the company did not receive any specific performance from the payment of the levy, they would not be able to identify assets or services.

One respondent[12] noted that the guidance proposed in paragraphs 62(a) (expected use of the proceeds) and 62(d) of the paper (other facts and circumstances) was particularly helpful. Conversely, in its view, it would be difficult to justify as assets or services the characteristics described in paragraphs 62(b) (stated purpose of the levy) and 62(c) of the paper (whether the levy replaces or reduces other payments due to the Governments).

One respondent[13] considered that the guidance proposed in paragraph 62 of the paper was helpful but noted that, even if the characteristics in paragraph 62(a) were met, it would not necessarily mean that the definition of an asset was met.

Finally, one respondent[14] believed that the proposed guidance was helpful but noted that, developing guidance to distinguish whether an asset rather than a service (or vice versa) was received, was not needed.

Question 4

> For those levies where the law indicates a point-in-time obligation, do you agree that there may be other elements in the law to designate the obligating event? If so, do you agree with the elements described in paragraphs 65 to 68?

Six respondents[15] answered this question.

Five respondents[16] agreed that there might be other elements in the law to designate the obligating event. One respondent[17] believed that it would depend on the requirements of each specific levy. The respondent noted that there were additional elements to be considered apart from those mentioned in the paper but he did not provide further details.

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[10] EDF, Norwegian Accounting Standard Board, Business Europe and the Dutch Accounting Standard Board.

[11] EDF.

[12] Business Europe.

[13] Dutch Accounting Standard Board.

[14] Norwegian Accounting Standard Board.

[15] ACTEO/AFEP/MEDEF, EDF, Norwegian Accounting Standard Board, Business Europe, Dutch Accounting Standard Board and ANC.

[16] ACTEO/AFEP/MEDEF, EDF, Norwegian Accounting Standard Board, Business Europe and ANC.

[17] Dutch Accounting Standard Board.

One respondent[18] fully agreed with the necessity to consider more than just the date specified in the law when identifying the obligating event. As an example, the respondent explained that in its jurisdiction it was not permitted to raise taxes by retroactive legislation. For that reason, to ensure that funds were generated as soon as possible, in some instances the solution chosen by the government was to set a trigger event on 1 January in year N+1 but based on data from year N. They believed that one might legitimately question whether the trigger event identified in the legislation was the substantive obligating event or rather the mechanism used to set the payment date. They also questioned whether the charge would relate only to one day or to the whole budgetary period for which it was raised.

One respondent[19] agreed with considering other elements in the law and explained that in its jurisdiction there was one levy proportionately reduced if the entity were to stop its activity during the year. The respondent explained that entities recognised this levy progressively. However, in its view, this approach would not solve the inappropriate approach of IFRIC 21 for levies that are measured based on balance sheet figures.

One respondent[20] considered the characteristic described in paragraph 67 of the paper particularly helpful (levy proportionately reduced based on the number of days in which the entity was in business during a period).

Other respondent[21] noted that where the levy is a proportion of an amount included in profit or loss, in substance, the obligating event is the activity performed progressively over time. Furthermore, this respondent explained that where a proportion of the levy was payable when the activity of the entity started or ceased during the year, even though the final obligating event might be a date outside that year, the substance would be a levy based on an activity rather than existence at a point in time.

One respondent[22] believed it was necessary to identify if a point in time obligation was the main (or the only) feature of the obligating event. If so, the entity had no choice but accounting for the levy when the point in time obligating event occurred. Conversely, when the law indicated that the levy was triggered by the generation of income over time, and that the last payment obligation was to be in operation at a specific point in time, this point in time obligation should be considered ancillary. Consequently, the entity should consider that the obligating event was the activity performed over time and it should recognise progressively the liability if it had no realistic alternative to avoid the payment.

Question 5

> In which cases, if any, a levy measured on a balance sheet figure can be linked to an activity performed over time, and therefore there is a conceptual basis to recognise it over time?

Five[23] respondents replied to this question.

[18] ACTEO/AFEP/MEDEF.

[19] EDF.

[20] Norwegian Accounting Standard Board.

[21] Business Europe.

[22] ANC.

[23] EDF, Norwegian Accounting Standards Board, Business Europe, Dutch Accounting Standard Board and ANC.

Two[24] considered that it was very difficult to recognise over a period those levies measured based on balance sheet figures.

One respondent[25] referred to levies raised on productive assets (property, plant and equipment) as an example of levies that, in its view, could be included in cost of inventories as fixed production overheads and recognised progressively in profit or loss in the period in which the cost of goods sold was recognised.

One respondent[26] believed that the basis for a levy will often lead to an asset or service to be received over time even when the measurement was based on asset values at a certain date. In its view, the reason for the measurement basis could be that this is considered a good indication of the entity's involvement in and exposure to a particular market or business.

One respondent[27] believed that there could be a basis for the progressive recognition of a levy measured on a balance sheet figure. In its view it implied assessing whether the balance sheet element had been supporting the activity over the period. Such an assessment was possible for generating assets or premises which were used by the entity in carrying out its operations over the period.

Question 6

Do you agree with the inclusion of a specific requirement in IAS 34 as a short term solution?

All respondents replied to this question. Five supported this alternative as a short term solution. Two[28] did not support the proposal.

One respondent[29] believed that the inclusion of an illustrative example dealing with levies in IAS 34 would be helpful. Four respondents[30] considered this alternative as the most effective solution.

One of this four respondents[31] suggested amending IAS 34 along the same lines as the existing model proposed by the FASB (Topic 270 Interim Reporting). In its view, IAS 34 should specify that because levies are related to a full year's activities but are incurred at infrequent intervals during the year, they need to be allocated to interim periods to avoid distortion of interim financial results. According to this respondent, the main short term objective should be to restore economic sense to interim financial statements even if it might lead to an accounting model which might be considered "impure" in terms of the accounting concepts behind it.

One respondent[32] noted that for levies measured on revenues or expenses over time, it would be relevant to recognise them in the interim reporting period on the basis of systematic and rational allocation procedures, in accordance with paragraph 4.51 of the Conceptual Framework. This constituent believed that IAS 34 requirements for contingent lease

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[24] Business Europe and Dutch Accounting Standard Board.

[25] EDF.

[26] Norwegian Accounting Standards Board.

[27] ANC.

[28] ICAC and Dutch Accounting Standard Board.

[29] Norwegian Accounting Standard Board.

[30] ACTEO/AFEP/MEDEF, EDF, ANC and Business Europe.

[31] ACTEO/AFEP/MEDEF.

[32] ANC.

payments, employer payroll taxes or year-end bonuses could be applied for levies when the entity had no realistic alternative but paying for them.

One respondent[33] believed that the inclusion of a specific requirement in IAS 34 as a short term solution would not be feasible. Another respondent[34] noted that a specific requirement in IAS 34 would imply amending IFRIC 21. This respondent was not in favour of short term solutions and preferred the principles in IAS 12.

Question 7

Do you agree that the IASB should add to its agenda a Research project to deal with transactions with Government authorities in their capacity as authorities?

Six respondents replied to this question[35]. One respondent[36] would not welcome such a proposal. In its view, further guidance regarding whether an entity is receiving an asset or a service in exchange for the payment of a levy and the inclusion of an illustrative example in IAS 34 would be sufficient to overcome the concerns raised with IFRIC 21.

Five respondents[37] would welcome the IASB carrying out such a research project. One[38] considered that both income taxes and levies might be addressed in a comprehensive project as they are both enacted by law and the counterparty is the Government. Another constituent[39] believed that it might be helpful but in its view the consequences of the revision of the Conceptual Framework might provide a quicker solution. Another respondent[40] considered that it would be helpful but believed that the accounting treatment of prepaid levies, including the definition of an asset, should also be taken into account. Finally, one respondent[41] noted that a research project should first focus on IAS 34 amendments since that alternative would be more efficient.

Question 8

Do you think that other different alternatives could be explored in the paper in order to reach a different outcome when accounting for levies?

Four[42] participants did not response to this question or were not aware of any different alternative pending to be explored in the paper.

One respondent[43] believed that the parallels with the accounting for emissions rights and costs could also be examined to achieve an overall consistent solution.

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[33] ICAC.

[34] Dutch Accounting Standard Board.

[35] All the respondents except EDF.

[36] Norwegian Accounting Standard Board.

[37] ACTEO/AFEP/MEDEF, ICAC, Business Europe, Dutch Accounting Standard Board and ANC.

[38] ACTEO/AFEP/MEDEF.

[39] Business Europe.

[40] Dutch Accounting Standard Board.

[41] ANC.

[42] ACTEO/AFEP/MEDEF, Norwegian Accounting Standard Board, ICAC and ANC.

[43] Business Europe.

One respondent[44] suggested, as an alternative, the creation of a separate standard addressing the accounting for levies.

One respondent[45] pointed out that an alternative approach could be explored for levies raised on productive assets (property, plant and equipment). In its view, these levies could be included in cost of inventories as fixed production overheads and recognised progressively in profit or loss in the period in which the related revenue is recognised. According to this respondent, the category of fixed production overheads includes all indirect costs of production that remain relatively constant regardless of the volume of production such as depreciation and maintenance of factory buildings and equipment and the cost of factory management and administration. The fact that a levy on assets is raised at a specific date and independently of the level of production does not lead to the exclusion of this levy from the category of fixed production overheads.

Other comments received

One respondent[46], although it believed that the direction taken in the review of the Conceptual Framework might lead to a more appropriate accounting treatment, considered it dangerous to change the definition and recognition for all liabilities for the sole purpose of solving a specific issue relating to levies. In addition, they considered that the completion of the Conceptual Framework and a potential reopening of IAS 37 would not occur in the foreseeable future.

One respondent[47] believed that the inclusion of the term 'no realistic alternative' in IAS 37 might have an effect on other provisions and might increase the magnitude of provisions. They explained that a company might reason that it has no realistic alternative but to continue to provide its service for ten years and, therefore, to provide for the levy for those ten years. They suggested the IASB should develop a new standard on levies and also consider the recognition and measurement provisions in IAS 12 because, in their view, the nature of levies is comparable to the nature of income taxes.

[44] Dutch Accounting Standard Board.

[45] EDF.

[46] ACTEO/AFEP/MEDEF.

[47] Dutch Accounting Standard Board.

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APPENDIX – List of respondents

Participant	*Country/Region*	*Nature*
ACTEO/AFEP/MEDEF	France	Preparer Association
EDF	France	Preparer
Norwegian Accounting Standards Board	Norway	National Standard Setter
Spanish Institute of Accounting and Auditing (ICAC)	Spain	National Standard Setter
Business Europe	Europe	Business Association
Dutch Accounting Standard Board	The Netherlands	National Standard Setter
Autorite Des Normes Comptables (ANC)	France	National Standard Setter