

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

TRANSFERS OTHER THAN EXCHANGES OF EQUAL VALUE

EFRAG

DISCUSSION PAPER

[MONTH] 2018

DRAFT

Foreword

This Discussion Paper is issued by the European Financial Reporting Advisory Group (EFRAG) as part of its Research activity. EFRAG aims to influence future standard-setting developments by engaging with European constituents and providing timely and effective input to early phases of the IASB's work. EFRAG carries out this research work in partnership with National Standard Setters in Europe to ensure resources are used efficiently and to promote stronger coordination at the European level. Four strategic aims underpin proactive work:

- engaging with European constituents to ensure we understand their issues and how financial reporting affects them;
- influencing the development of global financial reporting standards;
- providing thought leadership in developing the principles and practices that underpin financial reporting; and
- promoting solutions that improve the quality of information, are practical, and enhance transparency and accountability.

More detailed information about our research activities and current projects is available on the EFRAG website [add link].

DISCLAIMER

EFRAG, while encouraging debate on the issues presented in the paper, does not express any opinion on those matters at this stage.

Copies of the Discussion Paper are available from the websites of those bodies issuing it. A limited number of copies of the Discussion Paper will also be made available in printed form, and can be obtained from EFRAG.

The paper invites comment on its proposals via the 'Questions for Respondents' contained in pages [XX].

Such comments should be submitted by [DATE] using the 'Express your views' page on EFRAG website by clicking [here-insert hyperlink] or should be sent by post to:

EFRAG

35 Square de Meeûs B-1000 Brussels (Belgium)

All comments received will be placed on the public record unless confidentiality is requested.

Table of Contents

EXECUTIVE SUMMARY	5
QUESTIONS TO CONSTITUENTS	7
CHAPTER 1: OBJECTIVE OF THE PROJECT	9
WHY IS THIS RESEARCH UNDERTAKEN?	9
UNDERSTANDING THE PROBLEM	10
EXPECTED EFFECTS OF THE REVISED CONCEPTUAL FRAMEWORK	10
CHAPTER 2: SCOPE OF THE PROJECT	13
SCOPE DEFINITION	13
SCOPE EXCEPTIONS	13
CHAPTER 3: THE 4-STEP MODEL	15
<i>First Step</i>	16
<i>Second Step</i>	17
<i>Third Step</i>	18
<i>Fourth Step</i>	19
<i>Performance-related condition</i>	19
CHAPTER 4: PRACTICAL ISSUES	22
THE ROLE OF UNCERTAINTY	22
LIMITATIONS AND IMPLICATIONS	24
CHAPTER 5: PRESENTATION AND DISCLOSURES	25
APPENDIX 1 – GLOSSARY OF USED TERMS	26
APPENDIX 2 – ILLUSTRATIVE EXAMPLES	28
EXAMPLE 1 – SCOPE: COMMERCIAL TRANSACTION WITH GOVERNMENT	28
<i>Fact pattern</i>	28
<i>Accounting under current IFRS</i>	28
<i>Revised Conceptual Framework</i>	29
<i>EFRAG’s proposed approach</i>	29
EXAMPLE 2 – SCOPE EXCEPTION – TRANSFERS WITH SHAREHOLDERS	29
<i>Fact pattern</i>	29
<i>Accounting under current IFRS</i>	29
<i>Revised Conceptual Framework</i>	29
EXAMPLE 3 - LEVIES FOR PARTICIPATING IN A SPECIFIC MARKET	29
<i>Fact pattern</i>	29
<i>Accounting under current IFRS</i>	30
<i>Revised Conceptual Framework</i>	30
<i>EFRAG’s proposed approach</i>	30
EXAMPLE 4 - LEVIES ON BANK TRANSFERS	31

<i>Fact pattern</i>	31
<i>Accounting under current IFRS</i>	31
<i>Revised Conceptual Framework</i>	31
<i>EFRAG's proposed approach</i>	31
EXAMPLE 5 - CAPITAL GRANT	31
<i>Fact pattern</i>	31
<i>Accounting under current IFRS</i>	31
<i>Revised Conceptual Framework</i>	32
<i>EFRAG's proposed approach</i>	32
EXAMPLE 6 - INCOME GRANT	32
<i>Fact pattern</i>	32
<i>Accounting under current IFRS</i>	33
<i>Revised Conceptual Framework</i>	33
<i>EFRAG's proposed approach</i>	34
EXAMPLE 7 – RESEARCH GRANT	34
<i>Fact pattern</i>	34
<i>Accounting under current IFRS</i>	34
<i>Revised Conceptual Framework</i>	34
<i>EFRAG's proposed approach</i>	35

Executive Summary

- 1 During the IASB 2016 Agenda Consultation, some constituents identified transfers whereby entities do not directly receive (or give) approximately equal value as an area requiring attention by the IASB. These constituents identified several different transfers, including income taxes, levies, and government grants as examples in which the 'non-reciprocal' nature of the transfers contributed to the difficulties in accounting for them.
- 2 This Discussion Paper (DP) considers whether transfers other than exchanges of equal value (referred to as ToEEV) may have characteristics that could warrant a specific accounting treatment. For the purposes of this DP, ToEEV are defined as non-exchange transfers that are either:
 - a) non-voluntary transfers whereby the entity does not have the discretion to decide whether to enter into the transfer; or
 - b) voluntary transfers that are not designed to maximise the proprietary benefits of the resource provide.
- 3 The DP focuses on the timing and pattern of recognition and does not address measurement issues. These may be considered at a future development of the research project.
- 4 The scope of the research excludes transfers between entities and their majority shareholders in their capacity, or rate-regulated activities (which are part of a separate research project by the IASB).
- 5 For transfers within the proposed definition, the DP suggests an accounting model based on the following principles:
 - a) Transfers that contain performance-related conditions imposed on the resource recipient are recognised when (or as) the performance-related conditions are being satisfied.
 - b) Transfers that do not contain performance-related conditions but arise as a consequence of an identifiable activity (or a set activities are recognised when the underlying activity is performed. An example of this is a transfer tax paid upon the sale of a property.
 - c) For transfers that cannot be anchored to an underlying performance-related condition or to an underlying activity of the parties, the model considers that the notion of 'societal benefit' (ie the fact that the purposes of such transfers are not primarily to maximise the proprietary benefits to the resource provider) can play a significant role for accounting purposes. As it is not generally possible to identify specific patterns in which entities receive and consume the benefits of the general activity of the Government or contribute to them, it seems reasonable that many of these are rendered continuously. Therefore, for transfers that occur on a recurring basis the model suggests a straight-line recognition over the period between two payment dates would be appropriate.

- 6 Appendix 2 presents a number of examples to illustrate the application of the model - its scope, scope exceptions and proposals. The illustrative examples contain, for each fact pattern, a discussion of the accounting under the current IFRS Standards, the changes, if any, involved by the revised Conceptual Framework issued in 2018 and the accounting under the proposed model.
- 7 The DP acknowledges that the proposed model involves a significant level of judgement and may result in assets and liabilities being recognised at an earlier stage than under the existing requirements. This is because normal requirements result in assets being recognised only when the entity has acquired control, and liabilities being recognised only when an obligation has been incurred.
- 8 The DP also discusses the role of uncertainty in the recognition or measurement of transfers (in particular insofar as the transfers in scope are often conditional upon future events, such as the entity being in operation at a certain date, operating over a defined period of time or fulfilling certain conditions).

QUESTIONS TO CONSTITUENTS

EFRAG invite comments on all matters in this Discussion Paper, particularly in relation to the questions set out below. Comments are more helpful if they:

- a) address the question as stated;
- b) indicate the specific paragraph reference, to which the comments relate; and/or
- c) describe any alternative approaches EFRAG, [other National Standard Setters] should consider.

All comments should be received by [Submission date].

Question 1 – Objective of the project

In Chapter 1, the DP presents arguments to support developing an accounting treatment for non-exchange transfers with specific characteristics. These transfers include, but are not limited to, levies and Government grants. Although the new Conceptual Framework has introduced changes that may address some issues around the treatment of levies, the DP argues that there is need for a comprehensive model to provide a conceptual basis and a practical approach to these transfers

Q1.1 Do you agree that it is appropriate to develop a comprehensive model for the transfers in scope of the project, due to their specific characteristics?

Question 2 – Scope of the project

In Chapter 2, it is suggested to develop a model for non-exchange transfers that are either:

- a) non-voluntary transfers whereby the entity does not have the discretion to decide whether to enter into the transfer; or
- b) voluntary transfers that are not designed to maximise the proprietary benefits of the resource provide.

Q2.1 Do you agree with the proposed scope? If not, is there a different scope that would provide a better basis to develop a comprehensive model?

Question 3 – Application of the first step

The DP (paragraphs 3.5 to 3.8) proposes that when transfers include performance-related conditions, they are recognised as the condition is fulfilled. However, some transfers may include ToEEV and non-ToEEV components. The DP illustrates three possible approaches to allocate the total consideration.

Q3.1 Which of the approaches presented in paragraph 3.8 do you support, and why?

Question 4 – Application of the second step

The DP (paragraph 3.9 to paragraph 3.16) proposes that when transfers in scope arise as a consequence of an identifiable activity, the transfer is recognised when the activity occurs. However, in some case (for instance, the purchase of a depreciable asset) the activity affects the balance sheet and the profit or loss of the reporting entity at different times. The DP illustrates two possible approaches to recognise the transfer.

Q4.1 Which of the approaches presented in paragraph 3.16 do you support, and why?

Question 5 – The role of uncertainty

Some of the transfers in scope are subject to conditions. In Chapter 4, the DP discusses if in the presence of conditional uncertainty, recognition of expense-generating and income-generating transfers in scope should be subject to a symmetrical or asymmetrical approach.

Q5.1 Do you think that the recognition of expense-generating and income-generating transfers should be subject to a symmetrical or asymmetrical approach? Please explain your answer.

Chapter 1: Objective of the project

The project is based on the premise that certain transfers encompass an implicit 'societal objective' which makes them distinct from purely commercial transfers and should be reflected in their accounting treatment. In some cases, the accounting outcome could be the same as under the current requirements, but the approach in the paper attempts to provide a conceptual approach for the outcome.

Why is this research undertaken?

- 1.2 During the IASB 2016 Agenda Consultation, some constituents identified non-reciprocal transfers as an area requiring attention by the IASB. These constituents identified different types of transfers, including income taxes, levies, and government grants as examples 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. The IASB finally decided not to add this project to its agenda as it was not persuaded that grouping these topics would allow to find a common solution.
- 1.3 A vast array of such transfers exist and a number of IFRS Standards deal with them on a particular basis. For instance:
 - a) IAS 12 *Income Taxes* deals with the recognition and measurement of income taxes including tax incentives;
 - b) IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* deals with the accounting for grants, forgivable loans or low interest/interest-free loans;
 - c) IAS 41 *Agriculture* dealt with grants associated with biological assets;
 - d) IFRIC 21 *Levies* and IFRIC 6 *Liabilities Arising from Participating in a Specific Market* address the accounting for levies in the financial statement of the entity paying them.
- 1.4 A number of concerns could be raised in relation to the existing guidance. First, not all transfers with such characteristics are regulated under existing IFRS Standards. For instance, there is currently no explicit guidance for donations, grants and subsidies from other parties than Government or investment tax credits (excluded from both IAS 12 and IAS 20).
- 1.5 Furthermore, different recognition models coexist. For instance, IAS 20 essentially aims at matching the period in which a Government grant income is recognised in profit or loss with the related costs for which the grant is intended to compensate. In contrast, the model for grants in IAS 41 requires to recognise unconditional grant as income when the grant becomes receivable and conditional grant when the condition is satisfied. Therefore, investigating whether a comprehensive approach can be identified could be beneficial.

Understanding the problem

- 1.6 Transfers between independent parties normally have the following features: firstly, entities are willing to enter into the transfer; secondly, it is possible to identify what is exchanged and thirdly, it is reasonable to assume that transfers are carried out at arm's length.
- 1.7 In practice, however, one or more of these features may not apply to certain transfers such as transfers other than exchanges of equal value. Transfers other than exchanges of equal value could instead have some of the following features:
- a) they may be imposed, in the sense that entities do not freely elect to enter into the transfers, for example direct and indirect taxes;
 - b) it may not be possible to identify what good or services are exchanged between the entities involved in the transfer; or
 - c) the entities do not exchange equal value (or it may not be possible to determine if equal value has been exchanged).
- 1.8 The features mentioned in paragraph 1.7 may indicate how each of the characteristics could play a role to determine the accounting requirements for transfers other than exchanges of equal value.
- 1.9 First, the imposed nature of a transfer 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).
- 1.10 Secondly, the non-exchange nature of the 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.
- 1.11 Thirdly, the exchange of non-equal values may justify a different approach in selecting a measurement basis. However, this discussion paper focuses on recognition issues only.
- 1.12 Consequently, the nature of transfers other than exchanges of equal value creates difficulties in accounting which could warrant for a specific accounting treatment. The objective of this discussion paper is to consider whether the characteristics of those transfers may justify a different accounting treatment.

Expected effects of the revised Conceptual Framework

- 1.13 The IASB issued the revised *Conceptual Framework for Financial Reporting* ('*Conceptual Framework*') in the first quarter of 2018.
- 1.14 The newly issued *Conceptual Framework* does not contain concepts that specifically address 'non-reciprocal' transactions which it defines as transactions in which an entity gives (or receives) value from another entity without directly receiving (or giving) approximately equal value in exchange. In its deliberations, the IASB confirmed that the

guidance had been developed without assuming that all transactions are reciprocal exchanges. Consequently, the 2018 *Conceptual Framework focuses on resources that have the potential to produce economic benefits and obligations to transfer economic resources without considering the wider objective that those rights and obligations might have such as to benefit the society as a whole.*

- 1.15 Under the 2018 *Conceptual Framework* an asset is defined as a 'present economic resource controlled by the entity as a result of past events'. An entity controls an economic resource if the economic benefits arising from that resource flow to the entity rather than another party. In the revised *Conceptual Framework*, the aspect of control does not imply that the resource will produce economic benefits in all circumstances. Consequently, an asset is recognised even when there is a low probability that the asset will generate economic benefits for the entity.
- 1.16 The 2018 *Conceptual Framework* changes the definition of a liability. Under the current proposals, a liability is still recognised only if the entity has an obligation as a result of a past event, but the existence of the obligation is identified when both the following conditions are met:
- a) the entity has no practical ability to avoid the transfer of economic resources; and
 - b) the entity has received the economic benefits or taken an action that would result in the transfer.
- 1.17 The new articulation affects the timing and/or pattern of recognition of the liability in some but not all cases. This can be demonstrated with the following two examples for levies with different features in relation to the date/period of activity and the date/period of calculation:
- a) Example 1 - a levy is imposed to an entity for generating revenue during a year. The obligating event is when revenues are first generated in 20X2 but the levy is measured in relation to the revenues recognised in the prior period.
 - b) Example 2 – a levy is imposed to entities for being in operation on the last day of the year. In this case the activity date is the last day of the reporting period. The measurement is based on the net assets at the end of the period.
- 1.18 In both examples above, the entity does not have the practical ability to avoid the transfer, as the only way would be to stop its operations. In relation to the second criterion in paragraph 1.16b):
- a) In Example 1, the activity providing economic benefits is the generation of revenues in the prior year. Therefore, it seems that under the proposals the liability to pay the levy would be progressively accrued during the prior year;
 - b) In Example 2, where the amount to be paid is based on net assets at the reporting date, it is less clear to identify the moment when the entity takes the action that creates the obligation. It could either be argued that recognition would still be deferred until that date as under IFRIC 21, or that the entity has conducted activities leading to that balance during the full year and progressive accrual of the obligation would better represent how the obligation has arisen.

- 1.19 The IASB noted in the basis for conclusion that the 2018 *Conceptual Framework* had been developed without assuming that all transactions are reciprocal exchanges, and that the guidance supporting the liability definition was in particular developed with significant thought given to non-reciprocal transactions.
- 1.20 However, EFRAG considers that the determination of the 'taken an action that would result in transfer an economic resource' and factors to conclude that an entity has 'no practical ability to avoid' a transfer are subject to interpretations that would depend on the type of transaction under consideration.
- 1.21 Consequently, the changes included in the 2018 *Conceptual Framework* may not necessarily provide an obvious answer for the types of transactions considered in this discussion paper. It should be noted that the IASB has tentatively concluded that further guidance would be more appropriately developed if and when the IASB is developing an IFRS Standard for that type of transaction. EFRAG considers that the model presented in this paper provides both a conceptual basis and a practical approach well equipped to treat these transfers.

Chapter 2: Scope of the project

Scope definition

- 2.1 The scope of this Discussion Paper is the recognition of Transfers Other than Exchanges of Equal Value (referred to as 'ToEEV') which are defined as non-exchange transfers that are either:
- a) non-voluntary transfers whereby the entity does not have the discretion to decide whether to enter into the transfer; or
 - b) voluntary transfers that are not designed to maximise the proprietary benefits of the resource provide.
- 2.2 Non-exchange transfers are defined as transfers in which an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.
- 2.3 Often, transfers other than exchanges of equal value involve governments or government bodies in their capacity as such. This characteristic is not essential, but the involvement of the government is an indication that the transfer is pursuing an objective of social welfare.
- 2.4 Non-voluntary transfers are usually required by law or regulation, and it is often the case that it is harder to determine what is being exchanged as the benefit received is in the form of a wider societal benefit. Types of transfers that would fall into this category are: income taxes, levies and other taxes such as consumption taxes, property taxes, social insurance taxes, emission rights etc.
- 2.5 Voluntary transfers are transfers into which the resource provider enters freely and are normally subject to stipulations (conditions or restrictions). Types of voluntary transfers are government grants, donations, forgivable or low-interest loans etc.
- 2.6 An indicator that a transfer may be in the scope of this project is the tripartite nature of the arrangement. Under a grant arrangement, the entity is generally receiving resources from one party and providing services to other parties, such as the General Public. In a levy, the entity may be paying consideration to a Government body and receiving indirect benefits from the operation of another party.
- 2.7 The nature of both voluntary and non-voluntary transfers is such that the non-equal value exchange has an underlying wider objective to provide societal benefits to individuals, households or society. Such societal benefits can include social insurance, social security, social assistance, education, health, military services etc. ToEEV can also be triggered by conducting certain government-imposed social or environmental policies which may not directly relate to the delivery of goods or services but rather observe a particular behaviour.

Scope exceptions

- 2.8 Majority shareholders have the legal right to direct the entity into a transfer, and for some of these transfers it may be difficult to assess if the consideration exchanged is at arm's length, although in many jurisdictions there may be limitations to the majority shareholders to carry out transfers that are not at arm's length.

- 2.9 EFRAG decided to exclude these transfers because in this paper the main focus is on the timing and pattern of recognition. The issues around transfers between an entity and its majority shareholders in their capacity, or transfers between entities under common control, are more around the measurement (and, assuming that fair value is selected as the measurement basis, the accounting of the difference between fair value and the consideration exchanged, if any).
- 2.10 Rate-regulated activities (RRA) as defined in the active IASB project may include some transfers that would fall within the proposed scope. This is because rate regulation may include transfers that have a societal objective – i.e. regulation of tariffs for essential public goods and services. Additionally, on a single transaction basis, rate regulation may result in transfers other than of equal value to different customers. Considering the upcoming publication of a consultation document by the IASB, EFRAG has decided to exclude RRA from the proposed scope.
- 2.11 EFRAG has also considered the possible interactions of its approach with Income Taxes. The application of the proposed approach could change the measurement of income taxes, in interim periods compared to the current requirements in IAS 34 *Interim Financial Reporting*. IAS 34 requires an entity to apply the effective income tax rate expected for the year to the result before tax at the interim reporting date.
- 2.12 Having a similar outcome for income taxes and recurring levies does not seem conceptually erroneous, since both fund public services provided by governments. However, EFRAG notes that a change to the requirements for interim reporting should probably be considered as part of a broader revision to IAS 12. Moreover, it can be argued that current issues around income taxes are more related to measurement – especially for deferred taxes. At this stage, EFRAG has excluded income taxes from the scope of the ToEEV project to put the focus on recognition rather than measurement issues.

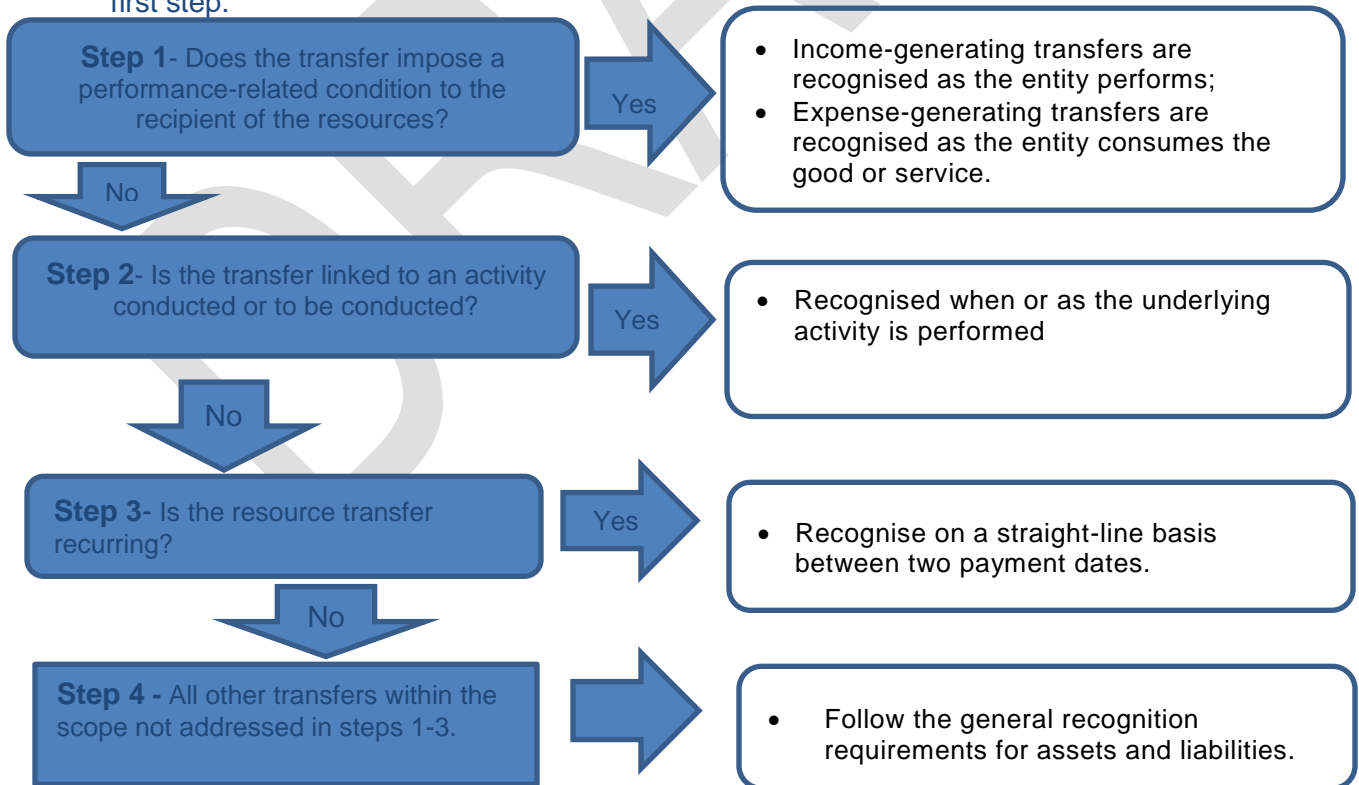
Chapter 3: The 4-step model

3.1 This chapter includes a description of the proposed accounting approach for ToEEV. In general, the model is based on the following notions:

- a) Transfers may fall within the proposed scope in full or partially. See paragraph 3.7 below for a discussion on whether an arrangement that includes both a ToEEV and a non-ToEEV component should be separated;
- b) For transfers within the proposed scope that contain performance-related conditions or that are linked to an underlying activity, the ToEEV is recognised when the performance-related condition is being satisfied or when the underlying activity is performed – see paragraph 3.15 below for a discussion of the recognition pattern when the underlying exchange affects the financial position and the financial performance differently;
- c) For other transfers within the proposed scope that occur on a recurring basis the purpose of ‘societal benefit’ is used to support a progressive recognition over time.

3.2 Appendix 2 presents a number of examples to illustrate the application of the model – its scope, scope exceptions and proposals. For each fact pattern, EFRAG has also described the existing accounting treatment and how it may change under the revised *Conceptual Framework* issued in 2018.

3.3 For clarity, the steps are presented in successive order. For instance, a transfer that meets the characteristics of both the first and second step shall be treated as described under the first step.



First Step

- 3.4 The first step of the approach applies to those transfers that impose a performance-related condition to the recipient of the resources. In that case, the entity is either paying for an identified good or service, or being compensated to provide one. These transfers are recognised following the usual requirements:
- a) income-generating transfers are recognised as the entity performs;
 - b) expense-generating transfers are recognised as the entity consumes the good or service.
- 3.5 In step one, some transfers may involve an exchange of good or service but the transaction price is not arm's length (because, for instance, the transfer is with a Government), and that would be in the scope of the project. However, since there was a performance-related obligation in the transfer, the relevant accounting model would be IFRS 15 *Revenue from Contracts with Customers*.
- 3.6 Further, a lot of income-generating non-reciprocal transfers such as Government grants are subject to conditions and stipulations. Some may argue that all conditions represent a sort of performance obligation. EFRAG considers that not all conditions or stipulations constitute performance-related conditions. Paragraphs 3.27 to 3.41, hereafter, include a discussion on the characteristics that could be considered to determine whether conditions or stipulations attached to transfers can be considered as performance-related conditions.
- 3.7 Transfers with performance-related conditions are within the scope of this project when the consideration exchanged does not equal in value the performance-related obligation. In such case, entities would have to assess whether the arrangement contains a non-exchange component to single out.
- 3.8 EFRAG has considered three possible alternatives for these cases:
- a) The entity should always allocate the full amount to the performance-related condition(s). This solution would result in more transfers being treated the same as commercial transaction at arm's length. It also reduces complexity. However, if the transfer involves the purchase of an asset and the entity is paying more than fair value, this creates a potential impairment issue;
 - b) The entity should allocate the full amount to the predominant component of the transfer. The entity would need to identify the predominant component, which may be possible to do with a qualitative assessment. If the ToEEV component was predominant the entity would then apply the following steps in the approach. However, this would imply that the entity may not recognise an exchange transaction or may still create a potential impairment issue;
 - c) The entity should allocate the amount to the different components using the guidance in IFRS 15. Since the ToEEV component could not be measured directly, the entity would apply the residual method. The entity would then apply the following steps of the approach to the ToEEV component. This solution would provide the most relevant information but would also increase complexity.

Second Step

- 3.9 The second step of the approach applies to those transfers that arises as a consequence of an identifiable activity (or set of activities) conducted or to be conducted by a specified party.
- 3.10 The activity is identifiable when it is possible to assess if and when it has been completed. The activity is not identifiable when the transfer arises as a consequence of general business activities, passage of time or being operating at a particular date.
- 3.11 Examples of transfers that would be treated under the second step include:
- a) Taxes on sales;
 - b) Grants related to assets;
 - c) Levies due on cash receipts from suppliers (in that case, the identifiable activity is to be conducted by a third party);
 - d) Voluntary contributions to unrelated parties – for instance, an entity may be co-funding a research projects without a final transfer of know-how.

Often, the counterparty of the ToEEV would be different from the counterparty of the identifiable activity.

- 3.12 The proposed approach rely on the premise that the activity (often an exchange transaction) is the event that triggers the transfer and may be the main motivation for the resource provider to engage into the transfer. The model suggests to 'anchor' the accounting of the non-exchange transfer on that exchange transaction.
- 3.13 Some activity involves exchange transactions that affect immediately profit or loss or only the balance sheet (like the receipt of a payment) and in that case the timing of the recognition of the ToEEV income or expense would occur at the same time. However, such exchange transaction involve the recognition of assets, in which case the question arises as whether the recognition of the ToEEV income or expense should occur at the time the identifiable activity affects the financial position of the entity or its profit or loss.
- 3.14 For instance, we examine below the case in Appendix 2 of a levy imposed on receipt of payment from customers. While the obligating event is the collection, the 'activity' generating the benefit to the entity is the sale. At that moment, the entity has also lost the practical ability to avoid the payment, as the only way to achieve this would be to forfeit the collection.
- 3.15 Similarly, an entity may receive a grant to invest in energy-saving equipment. The ToEEV income would fall in the second step if the condition is not deemed to be a performance-related condition, because the income is arising from on underlying activity (in this case an exchange transaction). The question arises as to whether the entity recognises the grant income when the asset is recognised (impact in the financial position) or as the asset is depreciated (impact on the profit or loss)?
- 3.16 EFRAG has identified two possible alternatives:

- a) the recognition of the ToEEV income or expense should be strictly based on the terms of the underlying activity. In the example, if the terms refer to 'purchase' the income should be recognised in full at that moment, while if the terms refer to 'purchase and use' the income should be recognised as the asset is depreciated;
- b) when the underlying activity affects financial position and profit or loss in different times, the recognition of the ToEEV income or expense should give prominence to the latter. This approach would be based on the notion that the ToEEV income or expense is consideration for a 'societal' component (not directly identifiable) that the entity receives or provides over a period of time. Under this alternative, Step 2 and 3 are substantially similar: the difference is that the date of the underlying activity is conducted is used at the place of the payment (or measurement) date.

Third Step

- 3.17 The third step of the approach applies to those transfers where no identifiable performance-related condition (Step 1) and no underlying activity or set of activities (Step 2). For these transfers in which non-equal values are exchanged value (such as some levies or grants from Governments) the proposed approach considers that the notion of 'societal benefit' can play a significant role and take precedence for the accounting
- 3.18 It is, of course, not possible to identify the pattern in which entities receive and consume the benefits of the general activity of the Government or contribute to them. However, it seems reasonable that many of these are rendered continuously: education, security, infrastructures, judicial system. Another possible justification could be that the economic substance of a recurring levy is that the entity is paying to operate over a period, and that this substance would be more faithfully represented by spreading the expense over the period to which the levy refers.
- 3.19 For these transfers the model therefore suggests that, for transfers with recurring payments, a straight-line recognition over the period between two payment dates would be appropriate. In those cases where the actual amount to be paid (or received) is known only at or after the payment date, an entity would need to accrue based on the best estimate of the liability and true-up at the payment date.
- 3.20 Conversely, when the entity receives resources at regular intervals and is not required to act in a specific way, it may be argued that the transfer is intended to compensate the benefit created by the entity's activity to the public at large.
- 3.21 EFRAG observes that for these transfers progressive recognition of the cost between two subsequent payment (or measurement) dates is considered by many the appropriate outcome, however this cannot be linked to the pattern of receipt or consumption of an identifiable asset or service.
- 3.22 EFRAG however observes that a similar straight-line allocation over a period when there is no clear evidence of a better or different pattern of consumption would not be a new concept as it is already allowed under some IFRS Standards for instance:
- a) IAS 38 *Intangible Assets* requires to amortise using a straight-line method, if that pattern cannot be determined reliably;

- b) When dealing with payments conditional on a service condition, IFRS 2 *Share-based Payment* requires to presume that the services will be received on a straight-line basis over the vesting period.

3.23 On that basis, the approach would result in a progressive recognition over a period:

- a) between two payment (or measurement) dates for cost-generating transfers; and
- b) over the period designated by the applicable law or regulation, for income-generating transfers.

3.24 In the case of recurring payments such as annual levies, a question arises as to the time horizon to consider to accrue for a liability. The approach proposed in this discussion paper retains the view in the revised *Conceptual Framework* that neither economic compulsion or the going concern principle are sufficient in themselves to imply that an entity has a present obligation to pay a levy that will be triggered by operating in a future period.

Fourth Step

3.25 The fourth step applies to the other transfers in scope. Although the 'societal benefit' notion could be relevant also for these, it is not possible to define a reference period and recognition of the income/expense shall follow the recognition of the asset/liability under the existing IFRS requirements.

3.26 Typically, this category will encompass transfers such as some one-off levies, penalties and fines, donations etc.

Performance-related condition

3.27 Step one of the proposed approach refer to the notion of performance-related condition.

3.28 EFRAG observes that IAS 20 and IAS 41 provide little guidance about what is meant by unconditional or conditional in the context of grants and similar transactions. Further guidance can be found in Public Sector Accounting Standards such as IPSAS 23 *Revenue From Non-Exchange Transactions (Taxes And Transfers)* which operates a distinction between two forms of stipulations contained in grant and similar government assistance:

- a) 'Restrictions' that limit or direct the purposes for which a transferred asset may be used, but do not specify that future economic benefits or service potential is required to be returned to the transferor if not deployed as specified. Where a recipient is in breach of a restriction, the transferor, or another party, may have the option of seeking a penalty against the recipient, by, for example, taking the matter to a court or other tribunal, or through an administrative process;
- b) 'Conditions' that require that the future economic benefits or service potential embodied in the asset is consumed by the recipient as specified or future economic benefits or service potential must be returned to the transferor.

3.29 The recipient of grants and similar benefits subject to conditions, as above defined, incurs a present obligation when it initially gains control of the transferred resource. This is because the recipient must either deliver particular goods or services to third parties or return to the transferor future economic benefits or service potential.

- 3.30 Some conditions are linked to the operations of the entity (e.g. receiving a grant to do research in a specified area). Such conditions are conceptually similar to the notion of performance obligation in IFRS 15, and therefore it may be argued that the requirements in that Standard could apply to such transfers.
- 3.31 However, a 'performance obligation' in IFRS 15 is defined as a promise to transfer goods or services to the customer, which is the party that has contracted with the entity and is committed to pay consideration. For ToEEV transfers, the entity may be required to perform to a party other than the party paying the consideration. So, the definition of performance obligation is narrow than 'performance-related condition'.
- 3.32 In this regard, EFRAG observes, that both the International Public-Sector Accounting Standard Board - IPSASB and the Government Accountant Standard Board - GASB have ongoing projects exploring how a performance obligation approach could be applied to transactions with Government, using IFRS 15 definition as the starting point with appropriate modifications made for the public sector.
- 3.33 The following paragraphs consider characteristics which could be considered to assess whether conditions attached to a transfer include performance-related conditions.

The conditions must have substance.

- 3.34 A term in a transfer agreement that requires the entity to perform an action that it has anyway no alternative but to perform, may lead to conclude that the term is in substance neither a condition nor a restriction and does not impose on the recipient entity a performance-related condition. An example of that would be a general condition of compliance with applicable laws.

The conditions must have economic effects for the grantee if not complied with.

- 3.35 The recipient must incur a present obligation to transfer future economic benefits or service potential to third parties (including the general public) when it initially gains control of an asset subject to a condition. As such the recipient is unable to avoid the outflow of resources (not complying with the conditions also has economic effects for the recipient). An example of that would be a condition that obliges the recipient to either use the funds to provide services within a certain period or return them to the grantor. If the recipient is not required to either consume the future economic benefits or service potential embodied in the transferred asset in the delivery of particular goods or services to third parties or else to return to the transferor future economic benefits or service potential, then the stipulation fails to meet the definition of a condition and would not create any performance-related condition.

The conditions must be sufficiently specific

- 3.36 Government assistance to entities can be aimed at encouragement or long-term support of business activities either in certain regions or industry sectors. Conditions to receive such assistance may not be specifically related to the operating activities of the entity. Conversely, some grants are more closely related to specific actions by the recipient, such as purchasing an asset or hiring a certain number of employees.
- 3.37 Conditions can vary greatly, from general promises that resources received will be used for the ongoing activities of a resource recipient to specific promises about the type, quantity

and/or quality of services to be delivered. Sometimes the specificity of services promised to be delivered by a resource recipient and agreed by the resource provider are implied rather than explicitly stated.

- 3.38 There might be agreements where delivery of services may not be specific or distinct so as to identify a performance-related condition (e.g. where the resource recipient promises to a resource provider that it will use transferred resources to finance a range of possible activities). In such agreements, it might be difficult to know what services have been transferred and if and when any performance-related conditions are fulfilled.

Fulfilment of the conditions must be liable to be assessed

- 3.39 Linked to the point above, the recipient should be able to assess if the performance-related condition has been fulfilled. There needs to be a minimum level of details and specification of such matters as the nature or quantity of the goods and services to be provided or the nature of assets to be acquired as appropriate and, if relevant, the periods within which performance is to occur.
- 3.40 Performance is generally monitored by, or on behalf of, the transferor on an ongoing basis. This is particularly the case when a condition a stipulation provides for a proportionate return of the equivalent value of the asset if the entity partially performs the requirements of the condition.

The realisation of the condition must be within the control of the entity

- 3.41 A condition such as an event outside the control of the entity would not create performance-related condition (e.g. a grant repayable if global market conditions or global economy improves).

Chapter 4: Practical issues

The role of uncertainty

- 4.1 The application of the second and third step of the model may result in assets and liabilities starting to be recognised at an earlier stage than under the existing IFRS requirements. This is because current requirements result in assets being recognised only when the entity has acquired control, and liabilities being recognised only when an obligation has been incurred.
- 4.2 Contribution or receipt of a societal benefit has a connotation of duration, while control or obligation may arise at a point in time – so the advantage of using the ‘societal benefit’ notion is to enable a progressive recognition. The implication is however that the role of ‘control’ and ‘obligation’ in recognition could be weakened.
- 4.3 If there was no uncertainty about the eventual occurrence of the transfer – in other words, if the entity was certain to pay or receive the resources – the alternative model proposed in this paper would only affect the timing and/or pattern of recognition. However, as noted above, the transfers in scope are often conditional on future events, such as the entity being in operation at a certain date, keep operating over a defined period of time or achieving certain thresholds. In such conditions of uncertainty, the alternative model proposed in this paper could cause an entity to start recognising a transfer that ultimately fails to occur.
- 4.4 The implication of this would be the need to reverse the accounting entry. Such reversals have a negative informative value because they create accounting noise in the performance of the entity and lower the predictive value of information,
- 4.5 Two questions arise around how to treat uncertainty in the proposed model for ToEEV:
- a) should this conditional uncertainty play a role in reference to the recognition or should it be incorporated in the measurement of the transfer?
 - b) should the answer be same for expense-generating transfer (such as levies) and income-generating transfer (such as grants)?
- 4.6 We will illustrate the first question with an example. under the proposed model, an entity accrues the liability for a levy recurring on an annual basis between two payment dates. Assume that the payment of the annual levy is depending on the entity meeting a certain threshold in its net assets at the end of the period – in that case there is a condition of uncertainty*.
- 4.7 If this condition is incorporated in the recognition, the entity would not start recognising the liability until the threshold is reached – in that case the outcome would differ from the proposed treatment of the ‘certain’ levy. If instead the uncertainty is incorporated in the measurement, the entity would still start recognising the levy from the same date and would reflect the likelihood of meeting the threshold in the amount of the provision.

* Currently, IFRS 23 par.12 indicates that if the obligating event is the reaching of a minimum threshold, the liability is recognised only after reaching the threshold.

- 4.8 EFRAG suggests that for the expense-generating transfers in scope of this project, this conditional uncertainty would play a role in measurement, not in recognition. This implies that, in certain circumstances, the initial accrual could be reversed.
- 4.9 In relation to the expense-generating transfers, the risk of reversal may be mitigated by the fact that they, for probably the most part, are non-voluntary.
- 4.10 In relation to the income-generating transfers, EFRAG understands that some have a preference for asymmetrical recognition of assets and liabilities. This asymmetrical recognition would follow from the application of prudence. The implication would be to maintain an essential role for control in relation to the recognition of asset.
- 4.11 On the other side, control of the resource may occur at any moment, and earlier than the payment date - in the absence of an identifiable performance-related condition, a model based only on control as the sole driver of recognition would lead to an immediate recognition of the income. This outcome occurs under IPSAS 23 and has raised concerns. The IPSAS has published a Consultation Document where it is suggesting - as one possible alternative - that all stipulations are considered to be like performance-related conditions. EFRAG observes that this option would result in practice to apply IFRS 15 requirements to ToEEV income-generating transfers.
- 4.12 EFRAG has identified two possible alternatives:
- a) the first one is to apply a symmetrical approach under which the societal benefit takes precedence over the control notion. Under this alternative, in some circumstances entities would start to recognise income (and assets) at an earlier date than under the revised *Conceptual Framework*. In this alternative, the uncertainty about receiving the resource would be incorporated in the measurement;
 - b) the second is to require a certain probability threshold as a condition to recognise income (and assets) for income-generating transfers under step two and three. This would introduce an element of asymmetry in the model which would reflect a notion of asymmetrical prudence. The threshold could be more or less high - 'probable', 'more likely than not' or 'not unlikely' - and would introduce an element of judgment and a risk of inconsistent application.

Limitations and implications

- 4.13 EFRAG acknowledges that the application of the model described above involves a certain degree of judgment.
- 4.14 The proposed approach requires to distinguish between transfers where a performance-related condition can be identified (for which normal recognition requirements would apply) and those where it does not. This requires identifying if the payer is obtaining an identifiable good or service in exchange for the consideration paid. There is an unavoidable element of judgment required in this.
- 4.15 For instance, in Australia oil and gas companies pay a levy to finance the National Offshore Petroleum Safety and Environmental Management Authority (NOPSEMA), Australia's independent expert regulator for health and safety, environmental management, structural and well integrity for offshore petroleum facilities and activities in Commonwealth waters.
- 4.16 Given the nature of activities of the regulator, it may be argued that the entity paying the levy is receiving an independent expert advice on their risk management plans. Alternatively, the regulations could have imposed that entities have these plans audited. If this interpretation is retained, the transfer would qualify for Step Two in the above model and the liability would be recognised as the entity receives the advice. If instead, it is concluded that there is no identifiable service received (and the entity is simply paying to fund the regulator, but not in exchange for something specific), then the transfer would qualify for Step Three and be recognised between two settlement dates.
- 4.17 If income taxes were included in the scope of application of the model, this would change the measurement of income tax in interim periods compared to the current requirements in IAS 34 recognition in interim periods of income tax. Currently income tax in interim periods is computed by applying the effective tax rate expected at year-end on the interim result. Income tax is therefore allocated to the interim periods not on a straight-line *pro-rata temporis* basis, but in proportion to the earnings before tax.
- 4.18 The application of the model would instead result in a linear allocation over time. This seems to be an unavoidable consequence, because both income tax and levies fund public services provided by governments. It is difficult to argue that income tax is linked to an identifiable activity or of activities; the taxable basis is profit and it results from an aggregation of activities and transactions. It would not be possible to allocate components to specific activities.

Chapter 5: Presentation and disclosures

- 5.1 Assets and liabilities recognised under the model described above, especially under Step 2 and Step 3 may warrant a specific presentation and/or disclosure.
- 5.2 Some judgment will be needed when identifying in general transfers that fall within the definition of ToEEV. Timing of recognition under Step 2 may also require judgment as the identification of the linked exchange will not always be obvious. Paragraph 122 of IAS 1 *Presentation of Financial Statements* requires entities to disclose the judgment other than estimations made in applying accounting policies and that have had the most significant effects on the amounts recognised.
- 5.3 Also, transfers under Sept 2 may not occur on a regular basis or their size could experience changes (compare a tax on investment disposal versus a recurring levy – the amount of the former may experience higher variance on a year-by-year basis). Separate presentation or disaggregation in the notes, if the amounts are material, would enhance the predictive value of the information.
- 5.4 Recognition of transfers under Step 3 may start when the conditions for the occurrence of the outflow/inflow have not yet fully realised (in the case of a revenue-generating transfer, the risk would be mitigated by introducing a probability threshold as discussed in paragraph 4.12 above). This exposes the transfer to a risk of reversal. Separate presentation or disaggregation in the notes, with an indication of the conditionality, would make the representation more faithful.
- 5.5 The general objective of the information to be separately presented or provided in the notes would be to enable users to evaluate the financial effects of these transfers. The information would include:
- a) The nature and total amount of assets, liabilities, revenue and expense recognised in the period;
 - b) Any adjustments to amounts recognised in prior periods;
 - c) A general description of the terms of the transfers, including their measurement basis;
 - d) A description of the unfulfilled conditions attached to the transfers, other contingencies and how they could affect the amounts already recognised (for instance, any penalties or claw-back provisions).
- 5.6 Another area where disclosures may be needed is when a transfer includes both a component that qualifies as a ToEEV and other components that fall outside the scope. As discussed above in paragraph 3.7 above, one possible solution would be that the entity allocates the full consideration to the predominant component. Under this solution, it would be appropriate that the entity discloses the basis to identify the predominant component.

Appendix 1 – Glossary of used Terms

- A1. The purpose of this glossary is to provide general and understandable explanations for the most important terms and definitions used in the Discussion papers. Many of the terms are extracted from the International Financial Reporting Standards (IFRS) or the International Public-Sector Accounting Standards (IPSAS) and used with the same meaning. References are indicated to the relevant Standard and paragraph number.

Terms	Definitions	Sources
Assets	A present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits.	Revised IFRS Conceptual Framework 4-3
Conditions on transferred assets	Conditions on transferred assets are stipulations that specify that the future economic benefits or service potential embodied in the asset is required to be consumed by the recipient as specified or future economic benefits or service potential must be returned to the transferor	IPSAS 23 - 7
Exchange/ non-exchange transactions/or transfers	Exchange transactions/transfers are transactions/transfers in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange Non-exchange transactions/ transfers are transactions that are not exchange transactions. In a non-exchange transaction/transfer, an entity either receives value from another entity without directly giving approximately equal value in exchange or gives value to another entity without directly receiving approximately equal value in exchange.	IPSAS 23 - 7
Government	Government, government agencies and similar bodies whether local, national or international.	IAS 20.3
Government assistance	Action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria.	IAS 20.3
Government grants	Assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.	IAS 20.3
Identifiable activity	An activity is identifiable when it is possible to assess if and when it has been completed. The activity is not identifiable when the transfer arises as a consequence of general business activities, passage of time or being operating at a particular date.	EFRAG's DP

Terms	Definitions	Sources
Income Tax	All domestic and foreign taxes which are based on taxable profits. Income taxes also include taxes, such as withholding taxes, which are payable by a subsidiary, associate or joint arrangement on distributions to the reporting entity	IAS 12 - 2
Levy	A levy is an outflow of resources embodying economic benefits that is imposed by governments on entities in accordance with legislation (ie laws and/or regulations), other than: (a) those outflows of resources that are within the scope of other Standards (such as income taxes that are within the scope of IAS 12 Income Taxes); and (b) fines or other penalties that are imposed for breaches of the legislation.	IFRIC 21 -4
Liabilities	A present obligation of the entity to transfer an economic resource as a result of past events. An obligation is a duty or responsibility that the entity has no practical ability to avoid.	Revised IFRS Conceptual Framework 4-26
Obligating event	An event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.	IAS 37.10
Obligation	An obligation is a duty or responsibility that an entity has no practical ability to avoid. An obligation is always owed to another party (or parties) which could be a person or another entity, a group of people or other entities, or society at large.	Revised IFRS Conceptual Framework 4-29
Restrictions (on transferred assets)	Stipulations that limit or direct the purposes for which a transferred asset may be used, but do not specify that future economic benefits or service potential is required to be returned to the transferor if not deployed as specified (IPSAS 23)	IPSAS 23 - 7
Stipulations (on transferred assets)	Terms in laws or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity.	IPSAS 23 - 7
Taxes	Taxes are economic benefits or service potential compulsorily paid or payable to public sector entities, in accordance with laws and or regulations, established to provide revenue to the government. Taxes do not include fines or other penalties imposed for breaches of the law.	IPSAS 23 - 7
Taxable event	Event that the government, legislature or other authority has determined will be subject to taxation (IPSAS 23).	IPSAS 23 - 7
Transfer	Act in which an entity receives assets or services or has liabilities extinguished	EFRAG DP

Appendix 2 – Illustrative examples

IE 1. EFRAG has considered in this Chapter the effects of the proposed approach to some of transfers that would be included in the scope of our Research project. For each fact pattern, EFRAG has also described the existing accounting treatment and how it may change under the forthcoming revised *Conceptual Framework*.

- a) **Example 1** – Scope: Commercial transaction with Government;
- b) **Example 2** – Scope exception: Transfer with shareholders;
- c) **Example 3** – Levies arising from participating in a specific market;
- d) **Example 4** – Taxation arising as consequence to credit movements on bank accounts;
- e) **Example 5** – Capital grant: government grant paid to an entity under the condition that the entity purchases a specified asset;
- f) **Example 6** – Income grant - government grant paid to an entity under the condition that the entity operates for three years (grants related to income with service condition); and
- g) **Example 7** - Research grant

Example 1 – Scope: Commercial transaction with Government

Fact pattern

IE 2. An entity enters into a service agreement to provide monthly payroll processing services to a Government body for one year. The transaction is made at commercial conditions (arm's length);

Accounting under current IFRS

IE 3. Exchange transactions with Governments as customers are within the scope of IFRS 15. The fact that the customer is a Government does not change the principles applicable to determine when revenue is recognised.

IE 4. Under the above fact pattern (derived from Example 13 of IFRS 15):

- a) The promised payroll processing services are accounted for as a single performance-related condition which is satisfied over time in accordance with paragraph 35(a) of IFRS 15 because the customer simultaneously receives and consumes the benefits of the entity's performance in processing each payroll transaction as and when each transaction is processed.
- b) The entity recognises revenue over time by measuring its progress towards complete satisfaction of that performance condition in accordance with paragraphs 39–45 and B14–B19 of IFRS 15.

Revised Conceptual Framework

- IE 1. No difference expected. Assets are defined as 'present economic resource controlled by the entity as a result of past events' and an economic resource is defined as a right that has the potential to produce economic benefits'.
- IE 2. Paragraph 4-8 of the Conceptual Framework further clarifies that '*some goods or services (...) are received and immediately consumed. An entity's right to obtain the economic benefits produced by such goods or services exists momentarily until the entity consumes the goods or services*'.
- IE 3. In this case, it could be argued that the entity gains control over the resource (i.e. contract revenue) as it performs its obligations under the contract

EFRAG's proposed approach

- IE 4. Since the transaction is voluntary and occurs at normal commercial terms, the transaction is not within the proposed scope (see paragraph 2.1 above). The entity accounts for the transaction under the applicable IFRS Standards.

Example 2 – Scope exception – Transfers with shareholders

Fact pattern

- IE 5. An entity enters into a CU 100 loan agreement with its majority shareholder at below-market rate.

Accounting under current IFRS

- IE 6. IFRS 9 required financial instruments to be initially recognised at fair value (IFRS 9). Where a loan is not on normal commercial terms however, the 'below-market' element of the transfer needs to be evaluated and separately accounted for. The relevant guidance would have to be looked at to account for that separate element.

Revised Conceptual Framework

- IE 7. The transfer could be non-voluntary and may fall within the proposed scope. As explained in paragraph 2.9 above, EFRAG decided to limit the scope of the project to exclude transfers between an entity and its majority shareholders. As a consequence, the entity would not apply the proposals in this DP to the transfer.

Example 3 - Levies for participating in a specific market

Fact pattern

- IE 8. A government charges an annual levy of 0.1% of total liabilities at the end of the reporting period. If the reporting period is longer or shorter than 12 months, the levy is increased or reduced proportionately.
- IE 9. It is assumed that there is no separately identifiable asset or service received in exchange for the levy payment.

Accounting under current IFRS

- IE 10. The entity applies IFRIC 21 and identifies what is the obligating event. If the legislation identifies the obligating event as being in business at the reporting date, the entity has no present obligation until that date, even if it is economically compelled to continue operating as a bank in the future.
- IE 11. In that case, the liability is recognised in full at point in time at the end of the reporting period, if the entity is operating as a bank at that specific date.

Revised Conceptual Framework

- IE 12. The Revised Conceptual Framework defines a liability as a 'a present obligation of the entity to transfer an economic resource as a result of past events.
- IE 13. Both the following conditions must be fulfilled to recognise a liability:
- a) The entity has no practical ability to avoid payment;
 - b) The entity has received economic benefits or conducted the activities that will or may require transfer of resources.
- IE 14. Paragraph 4-44 further clarifies that '(...) *the action taken could include, for example, operating a particular business or operating in a particular market. If economic benefits are obtained, or an action is taken, over time, the resulting present obligation may accumulate over that time*'.
- IE 15. Judgement needed to determine whether the entity has already obtained economic benefits at a point in time (i.e. obtained an authorisation to operate), or that it has taken an action (operate in a particular market) that accumulates over time.

EFRAG's proposed approach

- IE 16. The transfer is non-voluntary and does not involve an exchange of equal value and therefore falls within the proposed scope. The entity applies the analysis in the DP:
- a) Step 1 – The entity does not identify performance-related condition in the agreement. This is because being in business as a bank does not create a performance condition of its own.
 - b) Step 2 – The entity assesses whether the obligation arises as a consequence of a specific underlying activity. The entity notes the activity is not identifiable when the transfer arises as a consequence of general business activities, passage of time or being operating at a particular date.
 - c) Step 3 – The entity observes that the transfer is recurring and neither linked to a performance-related conditions (Step 1) nor to an identifiable activity or set of activities (Step 2) . For these transfers the model therefore suggests a straight-line recognition over the period between two payment dates. In those cases where the actual amount to be paid is known only at or after the payment date, the entity would need to accrue based on the best estimate of the liability and true-up at the payment date.

Example 4 - Levies on bank transfers

Fact pattern

IE9. The tax regulations in country X apply a transaction tax to all bank transfers. The tax is calculated based on 0.1% of the transfers and is payable the next month.

Accounting under current IFRS

IE 17. The entity applies IFRIC 21 and shall assess what is the obligating event under the legislation, the actual cash transfer or the original commercial transaction.

Revised Conceptual Framework

IE 18. Under the proposed definition of a liability, no present obligation exists until the entity has 'received economic benefits, or taken action and , as a consequence, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer'.

IE 19. The Conceptual Framework does not further define the term 'action and judgement would be needed, in the present fact pattern, to assess whether the 'action' taken by the entity is the cash movement or the original commercial transaction. Based on that assessment the levy may be recognised either at the underlying transaction date or at the payment date.

EFRAG's proposed approach

IE 20. The transfer is non-voluntary and does not involve an exchange of equal value therefore falls within the proposed scope. The entity applies the analysis in the DP:

- a) Step 1: The entity assesses that there is no identifiable performance-related condition in the transfer. This is because the levy is not subject to any specific stipulations.
- b) Step 2: The entity assesses that the transfer arises as a consequence of an identifiable underlying activity. The entity observes that the levy is triggered by bank payments and recognises the liability as this underlying activity is performed. However, further guidance may be needed to assess whether the underlying 'activity' to consider is the original commercial transaction(s) entered into (i.e. sale or purchase) or its settlement (i.e. the bank movement).

Example 5 - Capital grant

Fact pattern

IE 21. A Government provides a to an entity under the condition that the entity purchases a specified asset. The grant is fully payable when and only when the qualifying asset is purchased. There are no additional conditions or stipulations.

Accounting under current IFRS

IE 22. The entity applies IAS 20. A grant subject to condition is recognised only when there is 'reasonable assurance that the entity will comply with the condition'; and

IE 23. Government grants related to assets can be either:

- a) presented in the statement of financial position as deferred income and recognised in profit or loss on a systematic basis over the useful life of the asset; or
- b) deducted from carrying amount of the asset. The grant is recognised in profit or loss over the life of a depreciable asset as a reduced depreciation charge.

Revised Conceptual Framework

IE 24. Assets are defined as when 'present economic resource controlled by the entity as a result of past events'. In this case, it could be argued that the entity does not control the resource (grant) until it has complied with the condition and that is the purchase of the asset.

EFRAG's proposed approach

IE 25. The grant is a voluntary transfer for the resource recipient and does not involve an exchange of equal values. The entity assesses that the objective of the grant is not to maximise of the proprietary benefits of the Government and, therefore, concludes that the transfer falls within the proposed scope.

IE 26. Further, the entity applies the analysis in the DP:

- a) Step 1: The entity assesses that there is no performance-related condition. This is because the conditions attached to the grant do not create any performance i.e. identified goods or services to be transferred to the resource provider.
- b) Step 2: The entity assesses that the grant is arising as a consequence of an identifiable underlying activity to be conducted: the grant is conditional only upon the purchase of the qualified asset which is an exchange transaction. The grant would be recognised when the activity is performance that is when the asset is purchased because at that date the entity would have fulfilled will all the conditions under the grant agreement.

IE 27. The model would need be to determine whether the grant is taken as a profit, deducted from the cost of the asset or spread over the depreciation period for the Asset (See alternatives considered in paragraph 3.16).

Example 6 - Income grant

Fact pattern

IE 28. An entity is entitled to receive a CU 300 Government grant under the condition that the entity operates for three years in a specific area of the country. The grant is paid through 3 instalments of CU 100 on 1st of January of the following year.

- a) Permutation A: The grant is repayable in full to the Government if the entity fails to comply with the 3-year condition. No other conditions are stipulated.
- b) Permutation B: If the entity stops operating in the area, the amounts already received for past periods are however kept and the entity loses the right to receive the grant for the current and future periods (if any). No other conditions are stipulated.

Accounting under current IFRS

- IE 29. Under IAS 20, a conditional income grant is not recognised in income until there is 'reasonable assurance' that both (i) the entity will comply with the conditions attaching to it and (ii) the grant will be received. Receipt of a grant does not of itself provide conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.
- IE 30. A grant that does not impose specified future performance-related conditions on the recipient is recognised in income when the grant proceeds are receivable.
- IE 31. The grant is recognised in profit or loss 'on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. If payments were received in advance, the recipient would recognise a liability.
- IE 32. Therefore, in the considered fact patterns:
- a) *Under Permutation A*, the entity would have first to make an assessment as to whether it has reasonable assurance to remain operating in the area until the end of the 3-year period. If the condition is met it will then have to recognise the cumulative grant over the period, it recognises expenses the related costs for which the grant is intended to compensate.
 - b) *Under Permutation B*, the entity would have to assess whether the 3-year period condition has real substance and economic effects since the entity is entitled to retain any grant received at the end of each period regardless of its obligation to operate for 3 years. It could be considered that the entity obtains controls of the CU 100 instalment at the end of each fiscal year as the amount received is not repayable. A CU 100 grant would therefore be recognised at the end of each period.

Revised Conceptual Framework

- IE 33. In the revised *Conceptual Framework*, Assets are defined as 'present economic resource controlled by the entity as a result of past events'. Control is defined as the present ability to direct the use of the economic resource and obtain the economic benefits that may flow from it and includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it.
- IE 34. In the considered fact pattern:
- a) In the case of permutation A, it could be argued that the entity does not control the resource (grant) until the end of the third year when it has performed its obligation to operate. As payment is received in advance, the recipient recognises a liability as it incurs a present obligation to transfer future economic benefits.
 - b) In the case of permutation B, grants received for past period are not repayable and it could be considered that the 3-year activity period has no substance and no real economic effects for the entity.

EFRAG's proposed approach

- IE 35. The grant is a voluntary transfer for the resource recipient and does not involve an exchange of equal values. The entity therefore, concludes that the transfer falls within the proposed scope.
- IE 36. Applying Step 1, the entity determines that the grant includes a performance-related condition imposed on the resource recipient; that is the obligation to operate in a specified area. under-developed area. The entity concludes that it fulfils its performance-related conditions over 3 years and recognise the grant income accordingly over that period.

Example 7 – Research grant

Fact pattern

- IE 37. A manufacturer of medical devices successfully applied for financial support from a government to fund research into a particular new type of technology that could lead to improvement in healthcare.
- IE 38. The government agrees to reimburse entity 50% of specified project costs over a two-year period. In accordance with the agreement, the entity must meet specified targets with regards to testing of the technologies being developed. The entity must also prepare six-monthly progress reports for the government. Technologies developed under the agreement remain the property of the manufacturer.

Accounting under current IFRS

- IE 39. Under IAS 20 a government grant is not recognised until there is reasonable assurance that:
- a) the entity will comply with the conditions attaching to it; and that
 - b) the grant will be received. Receipt of a grant does not of itself provide conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.
- IE 40. The entity will first need to assess whether it has reasonable assurance to meet the specified targets before recognising the grant. If so, the grants shall be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate.
- IE 41. In the considered case as the grant is meant to reimburse 50% of specified project costs over two years, grants will be recognised as the expenses they make up for are incurred.

Revised Conceptual Framework

- IE 42. The revised *Conceptual Framework* defines assets as 'present economic resource controlled by the entity as a result of past events'. Control is defined as the 'present ability to direct the use of the economic resource and obtain the economic benefits that may flow from it. Control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it.
- IE 43. In the fact pattern described, it could be argued that the entity does not control the resource (grant) until it has performed its obligations. As payment was received in advance, the

recipient recognises a liability as it incurs a present obligation to transfer future economic benefits.

EFRAG's proposed approach

- IE 44. The grant is a voluntary transfer for the resource recipient and does not involve an exchange of equal values. The entity therefore, concludes that the transfer falls within the proposed scope.
- IE 45. Applying Step 1, the entity assesses whether the conditions contained in the grant qualify as a performance-related conditions.
- IE 46. The entity assesses that ,under the grant agreement, no identifiable good or services are transferred to the Government and in, particular, the outcome of the research and any technologies developed under the agreement remain the property of the manufacturer.
- IE 47. Applying Step 2, the entity assesses that the grant is linked to an underlying identifiable activity; that is its research activity. The entity observes that the grant is subject to requirements to do the research, meet specific targets and report back to the Government. This create a present obligation when it initially gains control of the transferred resource. If not complied with, the grant is returned to the transferor.
- IE 48. The receivable and grant revenue will be recognised as the entity fulfils its research obligations over the two-year period. This may not coincide, like under current accounting under IAS 20, with the way expenses are incurred over the project. See above in paragraph 4.12 for a discussion on the role of uncertainty.



EFRAG receives financial support of the European Union - DG Financial Stability, Financial Services and Capital Markets Union. The contents of this document are the sole responsibility of EFRAG and can under no circumstances be regarded as reflecting the position of the European Union.

DRAFT