

TRANSFERS OTHER THAN EXCHANGES OF EQUAL VALUE (TOEEV)

EFRAG DISCUSSION PAPER

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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 Discussion Paper, has not reached a final conclusion on those matters at this stage.

A limited number of copies of the Discussion Paper will also be made available in printed form, and can be obtained from EFRAG.

The Discussion Paper invites comment on its proposals via the 'Questions for Respondents' contained in pages 7 to 8.

Such comments should be submitted by **29 March 2019** using the 'Express your views' page on EFRAG website by clicking **[here-insert hyperlink]** or should be sent by post to:

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

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Executive Summary

- 1 When responding to the IASB's 2016 Agenda Consultation, some constituents identified transfers whereby entities do not directly receive (or give) approximately equal value as an area requiring attention. These constituents identified several different transfers, including income taxes, levies, and government grants, as examples in which the 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) have differentiating characteristics that could warrant a specific accounting treatment.
- 3 The DP describes the factors to consider in assessing whether a transfer qualifies as a ToEEV. This assessment requires judgment based on all information reasonably available to the entity. The DP explains what factors are normally relevant to the assessment, such as the transfer being imposed or the involvement of government bodies acting in this capacity.
- 4 For the reasons indicated in paragraphs 2.14 and following, it is proposed to exempt from the scope of the project transfers between entities and their majority shareholders in their capacity, income taxes and rate-regulated activities (the last being currently addressed in a separate project by the IASB).
- 5 The DP focuses on the timing and pattern of recognition rather than measurement issues such as the use of an expected or more likely outcome. Issues related to measurement may be considered at a future stage of the research project.
- 6 For ToEEV in scope, the DP explores an approach with the following characteristics:
 - a) Transfers may qualify as ToEEV in full or only partially. Paragraph 2.12 discusses how an arrangement that includes both a ToEEV and a normal commercial exchange should be separated;
 - b) ToEEV that impose performance-related conditions or are linked to an underlying activity are recognised when the performance-related condition is satisfied or the underlying activity is performed – see paragraph 3.14 below for a discussion of the recognition pattern when the underlying exchange affects the financial position and the financial performance at different times;
 - c) Other ToEEV that do not have these characteristics and occur on a recurring basis are recognised on a straight-line basis between two payment dates. For these transfers, the approach explored in the DP considers that, since the primary purpose of these transfers is not to create proprietary benefits for the resource provider, they are likely to encompass some form of 'societal benefit. As it is not generally possible to identify specific patterns in which entities receive and consume societal benefits, such in the case of those created by 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 approach explored in the DP suggests straight-line recognition over the period between two payment dates.

- 7 The purpose of the DP is to provide a comprehensive approach and conceptual basis for the recognition of ToEEV. In some cases the approach explored in the DP may not change the accounting outcome under existing requirements but in other cases may require recognition of assets and liabilities at an earlier stage. This is because the approach explored in the DP does not necessarily require the existence of a present obligation or control in order to recognise a liability or an asset respectively. Chapter 4 discusses if the approach should have symmetrical recognition requirements for cost-generating and income-generating ToEEV.
- 8 The DP also discusses the role of uncertainty in the recognition or measurement of ToEEV (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).
- 9 Appendix 2 presents a number of examples to illustrate the application of the approach explored in the DP- its scope, exclusions 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 approach explored in the DP.

QUESTIONS TO CONSTITUENTS

EFRAG invites comments on all matters in this DP, 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 should consider.

All comments should be received by **29 March 2019**.

Question 1 – Objective of the project

In Chapter 1, the DP presents arguments to support developing an accounting treatment for Transfers other than Exchanges of Equal Value (ToEEV). ToEEV 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 approach to provide a conceptual basis and a practical approach to accounting for ToEEV.

Q1.1 Do you agree that ToEEV have differentiating characteristics that warrant the development of a specific accounting treatment?

Question 2 – Scope of the project

In Chapter 2, it is suggested to explore an approach for ToEEV that are either non-voluntary transfers, or voluntary transfers except those identified in paragraphs 2.14 to 2.19. Chapter 2 describes what is the nature of ToEEV and what factors would guide an entity is assessing whether a transaction is or contains a ToEEV.

Q2.1 Do you agree with how the scope has been defined? If not, is there a different scope that would provide a better basis for developing a comprehensive approach?

Q2.3 Is the definition of ToEEV and the guidance around the assessment of their existence sufficiently clear and operational?

Q2.2 Do you agree with the proposed exclusions from the project? In particular, do you think that the approach could be fit also for income taxes?

Question 3 – Transactions that include a ToEEV

The DP suggests that a transaction could include a normal commercial exchange and a ToEEV. Paragraph 2.12 of the DP illustrates three possible methods to allocate the total consideration.

Q3.1 Which of the methods presented in paragraph 2.12 do you support, and why?

Question 4 – Application of the Second Step

The DP (paragraph 3.6 to paragraph 3.14) proposes that when transfers in scope arise as a consequence of an identifiable underlying 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 recognising the transfer.

Q4.1 Which of the approaches presented in paragraph 3.14 do you support, and why?

Question 5 – Application of the Third Step

The DP (paragraph 3.15 to 3.22) proposes that ToEEV that do not fall in either the first or second step of the approach explored, and are recurring, are recognised progressively between two payment dates. The rationale for this is that the entity is sharing into contributing or contributing to a 'societal' benefit. This is assumed to occur in a constant pattern over the period of time, which results in a linear recognition pattern.

Q5.1 Do you think agree with the outcome? And do you believe that the notion of 'societal benefit' provides a conceptually adequate basis to support the outcome?

Question 6 – The role of uncertainty

Some of the transfers in scope are subject to conditions. Paragraphs 4.3 to 4.13 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

Why is this research undertaken?

- 1.1 When responding to the IASB's 2016 Agenda Consultation, some constituents identified transfers whereby entities do not directly receive (or give) approximately equal value as an area requiring attention. These constituents identified several different transfers, including income taxes, levies, and government grants, as examples in which the nature of the transfers contributed to the difficulties in accounting for them.
- 1.2 Commercial transfers between independent parties normally have the following features: firstly, both parties have the ability to decide whether to enter into the transfer; and, secondly, it is possible to identify what is exchanged between the parties. Based on this, it is reasonable to assume that when a party engages into a commercial transaction, it has assessed that it is exchanging equal value.
- 1.3 However, in some cases entities engage in transfers that do not have one or both of the normal characteristics of commercial transactions noted in paragraph 1.2, in other words transfers in which:
 - a) it is not possible to identify the goods or services received in exchange for the consideration; or
 - b) the goods or services received and the consideration transferred are of unequal value.
- 1.4 Many, but not all, of these transfers are imposed in the sense that entities do not have the ability to freely elect to enter into the arrangement. Examples imposed transfers included direct and indirect taxes.
- 1.5 Each feature in the above two paragraphs could be relevant in determining the reporting for these transfers. First, the imposed nature of a transfer may be relevant to define 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).
- 1.6 Secondly, the lack of an identifiable good or service received may be relevant in assessing the pattern of allocation in profit or loss. In the case of an outflow, cost is normally 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 any goods or services, or is unable to identify them, then a different driver needs to be used.
- 1.7 Thirdly, the exchange of non-equal values may be relevant in selecting the measurement basis. Conceptually, an entity that pays consideration without receiving an identifiable good or service and an entity that pays a consideration that is disproportionate to the good or service received are in a similar economic position – in both cases, it would be possible to argue that there is a component that is not a transfer of equal value, and both should be reported similarly.

- 1.8 EFRAG acknowledges that the application of this third feature would require the use of judgment – the imposed nature of the transfer is objectively determinable while the lack of equal value is more subjective, since equal value is different from fair value. We will discuss below in paragraph 2.3 and following what factors can be relevant to the assessment.2.4 and following what factors can be relevant to the assessment.
- 1.9 We will refer to transfers that have one or more of the characteristics in paragraph 1.3 as Transfers Other than Exchanges of Equal Value (ToEEV) and we will discuss if their nature could require a specific accounting treatment.
- 1.10 If one party is not giving (or receiving) equal value, the question arises on why the transfer occurs and what is the motivation to enter into it. For transfers that are imposed by law, such as taxes, the question may seem superfluous since the entity has no freedom to avoid it.
- 1.11 For transfers that are voluntary, EFRAG suggests that for at least one of the parties, the motivation encompasses an implicit goal of ‘societal benefit’ that goes beyond the maximisation of the proprietary benefits in monetary terms. Donations are an immediate example but it could also be an entity providing a low-interest loan to a supplier to develop a research project without future transfer of know-how. In this case, the direct monetary advantage for the resource provider is not maximised (although there can be indirect benefits, like the expectation of reduced purchase costs in future) and it could be argued that there is a societal benefit involved.
- 1.12 If the perspective of both parties involved is considered, then the motivation can be validly applied also to transfers that are imposed. These transfers are usually conducted with Government¹ in their capacity as such and it may be argued that transfers to and from Governments are aimed at contributing to society at large. For instance, when a Government concedes a non-refundable grant to an entity to purchase an asset with low-environmental impact, the aim is to reduce pollution; payments of taxes go to the general Government budget; when an entity is required to build general infrastructure (such as a road) in exchange of a licence to develop a real estate project, this is aimed at improving mobility for the general public; and so on.
- 1.13 The purpose of this DP is to propose an approach for the reporting of these transfers, with a focus on the timing and pattern of recognition. The approach described is not intended to necessarily result in an accounting outcome different from the existing requirements of IFRS Standards, but attempts to provide a conceptual basis and develop a systemic treatment.

¹ Transfer with shareholders could also be considered as imposed. However, these transfers are not in the scope of this DP.

Is there a problem with the existing guidance?

- 1.14 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 nature of the transfers (commonly referred to non-reciprocal) 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.
- 1.15 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) IFRS 2 *Share-based payment* paragraph 13A specifies that if the identifiable consideration received by the entity appears to be less than the fair value of the instrument granted, typically this indicates that other consideration (i.e. unidentifiable goods or services) has been or will be received by the entity;
 - e) IFRIC 21 *Levies* and IFRIC 6 *Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment* address the accounting for levies in the financial statements of the entity paying them.
- 1.16 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).
- 1.17 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.

Expected effects of the revised Conceptual Framework

- 1.18 The IASB issued the revised *Conceptual Framework for Financial Reporting* ('2018 *Conceptual Framework*') in March 2018.

- 1.19 The 2018 *Conceptual Framework* refers to ‘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. However, it does not contain specific requirements for such transactions. The IASB noted in the Basis for Conclusions 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 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.
- 1.21 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.
- 1.22 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 on 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 on 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.
- 1.23 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 before the date specified in the regulation. In relation to the second criterion in paragraph 1.21b):
- 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 how 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 changes in that balance during the full year and progressive accrual of the obligation would better represent how the obligation has arisen.
- 1.24 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.
- 1.25 Consequently, it is not clear that changes included in the 2018 *Conceptual Framework* provide an answer for all types of transactions considered in this DP. EFRAG considers that the approach explored in the DP provides both a conceptual basis and a practical approach suitable for these transfers.
- 1.26 In EFRAG's view, the 2018 *Conceptual Framework* focuses on resources that have the potential to produce economic benefits and obligations to transfer economic resources to the reporting entity. In this DP, EFRAG wants to obtain constituents views on whether the accounting requirements should consider the wider objective that some rights and obligations might have such as to benefit the society as a whole.

Chapter 2: Scope of the project

Definition and identification of ToEEV

- 2.1 In this DP, we will refer to Transfers Other than Exchanges of Equal Value (referred to as 'ToEEV'), which are defined as transfers where an entity either receives value from another party (or gives value to it) without directly giving (receiving) approximately equal value in exchange.
- 2.2 This DP proposes an approach for transfers that meet the definition of ToEEV and:
 - a) are non-voluntary, i.e. the entity does not have the discretion to decide whether to enter into the transfer; or
 - b) are voluntary except those identified in paragraphs 2.14 to 2.20.
- 2.3 When an entity receives resources and provides no or nominal consideration directly in return, it will be clear that the transfer is a ToEEV. Other transfers may involve both exchange and non-exchange components. An entity would have to assess whether the transfer is or contains a ToEEV.
- 2.4 An exchange of equal value is assessed from the perspective of the entities, and not from the perspective of a generic market participant. When the fair value of the consideration exactly equals the fair value of the goods or services exchanged, this can be assumed to be an exchange of equal value. When this is not the case, the transaction may still be an exchange of equal value from the perspective of the parties.
- 2.5 For instance, a supplier may decide to extend a commercial discount to a new or existing client to enhance the commercial relationship. In that case, the supplier has assessed that, once the value of the commercial relationship is included, the transaction is still an exchange of equal value (although the fair value of the price paid by the customer does not equal the fair value of the performance of the supplier).
- 2.6 In performing the assessment, entities would be expected to take into account all information reasonably available. However, entities would not be expected to undertake an exhaustive search of each transactions to determine if they contain a ToEEV. EFRAG considers that such an approach is consistent with recently issued IFRS Standards, for instance IFRS 17 *Insurance Contracts* in relation to the identification of an investment component.
- 2.7 Certain indicators would normally guide the assessment, For example, ToEEV frequently 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 parties are not meant to maximise their proprietary economic benefit. The government body may require the entity to provide resources at less than equal value to pursue a societal benefit; or may transfer resources to the entity for that purpose.

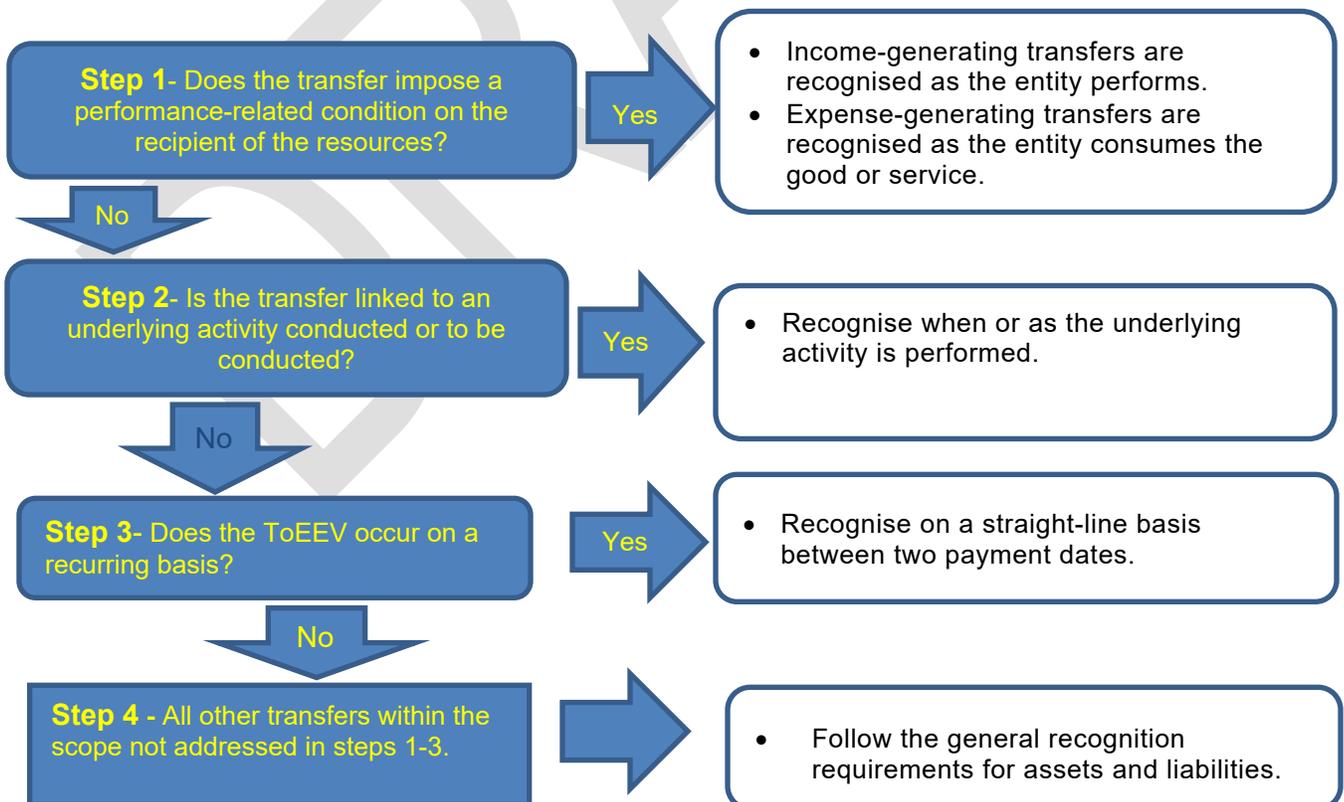
- 2.8 In a non-voluntary ToEEV, it is often the case that it is hard to determine if the entity receives an identifiable good or service. Instead, the entity benefits from the availability of general services provided by the government to the society. Types of transfers that would fall into this category are: income taxes, levies and other taxes such as consumption taxes, property taxes, social insurance taxes, emission rights.
- 2.9 Another indicator that a transaction is or includes a ToEEV is the tripartite nature of the arrangement. For instance, under a government grant arrangement, the beneficiary 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 the levy to a Government body and receiving indirect benefits from the operation of another party.
- 2.10 In a voluntary ToEEV, the entity participating is often subject to stipulations (conditions or restrictions). As discussed below, these stipulations can provide a basis for recognition basis of the transfer. Types of voluntary transfers include government grants, donations, forgivable or low-interest loans.
- 2.11 The resource provider may receive value indirectly by sharing into a societal benefit. Such societal benefits can include social insurance, social security, social assistance, education, health, or military services. ToEEV can also arise with 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 or course of actions.
- 2.12 When a transaction includes a normal commercial exchange and a ToEEV, EFRAG has considered three possible alternatives:
- a) The entity should always allocate the full amount to the normal commercial exchange and account for it under the applicable Standard. This solution reduces complexity and would result in more transfers being treated as if they were normal commercial exchanges. However, an impairment issue arises if the transfer involves the purchase of an asset for more than fair value.
 - 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 was predominant, the entity would then apply the four-step approach as described in Chapter 3 (unless the transfer is excluded from the project). 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 could not be measured directly, the entity would apply the residual method. The entity would then apply the four-step approach to the identified ToEEV (unless the transfer is excluded from the project). This solution would provide the most relevant information but would also increase complexity.
- 2.13 In conclusion, an element of contribution to or sharing in a societal benefit can be identified in many ToEEV. In the approach explored in the DP, this feature is also used as a basis for recognition when other characteristics such as the existence of performance-related conditions cannot be identified.

Exclusions from the project

- 2.14 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.
- 2.15 EFRAG decided to exclude these transfers because the main focus of this DP is 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 presentation of the difference between fair value and the consideration exchanged, if any.
- 2.16 Rate-regulated activities 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 these activities from the project.
- 2.17 EFRAG has also considered the possible interactions of its approach with income taxes. Conceptually, a similar outcome for income taxes and recurring levies does not seem problematic, since both fund public services provided by governments.
- 2.18 However, EFRAG notes that current issues around income taxes are more related to measurement – especially for deferred taxes. We are not aware of concerns about the timing and pattern of recognition for income taxes.
- 2.19 Moreover, the application of the approach explored in the DP may affect the measurement of income taxes in interim periods, compared to the current requirement. IAS 34 *Interim Financial Reporting* requires an entity to apply the effective income tax rate expected for the year to the result before tax at the interim reporting date.
- 2.20 Considering the focus of this DP, and that EFRAG is unaware of current concerns about the IAS 34 approach to income taxes in interim periods, at this stage EFRAG is proposing to exclude income taxes from the scope.

Chapter 3: The 4-step approach

- 3.1 This chapter explores a comprehensive approach to the reporting of ToEEV. The key features are the following:
- Transfers may fall within the proposed scope in full or partially. See paragraph 2.12 for a discussion on how an arrangement that includes both a ToEEV and a normal commercial exchange should be separated;
 - ToEEV may impose *performance-related conditions* or be *linked to an underlying activity*. If this is the case, they are recognised when the performance-related condition is satisfied or the underlying activity is performed – see paragraph 3.14 below for a discussion of the recognition pattern when the underlying exchange affects the financial position and the financial performance at different times;
 - Other ToEEV that *occur on a recurring basis* are recognised progressively over time to reflect the notion of contributing to, or sharing in, ‘societal benefit’.
- 3.2 Appendix 2 presents a number of examples to illustrate the application of the approach explored – its scope, exclusions 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 consecutively although some steps may be combined. For instance, a ToEEV that meets the characteristics in 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 ToEEV that impose a performance-related condition on the recipient of the resources. In that case, the entity is either paying for an identified good or service, or being compensated for providing 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 Often income-generating ToEEV such as Government grants are subject to conditions and stipulations. If all conditions were deemed to represent a performance obligation, then most income-generating ToEEV would fall within the first step. EFRAG considers that not all conditions or stipulations constitute performance-related conditions. Paragraphs 3.25 to 3.39 include a discussion of the characteristics that could be considered to determine whether conditions or stipulations attached to transfers can be considered as performance-related conditions.

Second Step

- 3.6 The second step of the approach applies to ToEEV that arise as a consequence of an identifiable underlying activity (or set of activities) conducted or to be conducted by a specified party. These transfers are recognised as the underlying activity occurs.
- 3.7 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 operating in a particular jurisdiction or market at a particular date.
- 3.8 Examples of transfers that would be treated under the second step include:
- a) Taxes on sales;
 - b) Grants related to the purchase or construction of a long-term asset;
 - c) Levies due on cash receipts from suppliers (in that case, the identifiable activity is to be conducted by a third party);
 - d) Some voluntary contributions to unrelated parties – for instance, an entity may be co-funding a research projects without a final transfer of know-how.
- 3.9 The counterparty of the ToEEV may be different from the counterparty of the identifiable activity.
- 3.10 The approach explored in the DP relies on the premise that the activity (often an exchange transaction) is the event that gives rise to the transfer and may be the main purpose for the resource provider to engage into the transfer. The approach suggests the accounting for the ToEEV is 'anchored' to that exchange transaction.

- 3.11 When the underlying activity affects at the same time both profit and loss and balance sheet, or only affects balance sheet (such as the receipt of a payment) the ToEEV is recognised at that same moment. When the underlying activity affects balance and profit and loss in different moments (such as the purchase of a long-term asset that is subsequently depreciated) the question arises as whether the recognition of the ToEEV should occur at the time the identifiable activity affects the financial position of the entity or its profit or loss.
- 3.12 For instance, Illustrative Example 4 in Appendix 2 addresses a levy imposed on payments to suppliers. While the obligating event is the payment, the 'activity' generating the benefit to the entity is the purchase. 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 refuse to settle its obligation
- 3.13 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 an 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).
- 3.14 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 when the purchase is recognised, while if the terms refer to 'purchase and use' the income should be recognised as the asset is depreciated;
 - b) when the underlying activity determines the amount of the transfer at one date but affects profit or loss at a different date, 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 Step 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

- 3.15 The third step of the approach applies to ToEEV that do not impose performance-related conditions (Step 1) and are not linked to an underlying activity or set of activities (Step 2). For these, the approach explored in the DP links the recognition to the notion of 'societal benefit' that has been introduced in paragraph 1.11 due to the lack of other characteristics.
- 3.16 It is not possible to define exactly the pattern in which entities generate or consume 'societal benefits', such as the benefits of the general activity of a Government. It seems reasonable to assume that many of these are consumed or received continuously: education, security, infrastructures, judicial system.

- 3.17 The approach explored in the DP results in a recognition of the ToEEV that reflects the assumed (continuous) pattern of consumption or generation of societal benefits. Given that the actual pattern is not observable, the DP proposes a straight-line recognition over the period between two payment dates. 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 payment and true-up at the payment date.
- 3.18 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.
- 3.19 EFRAG observes that for these transfers progressive recognition of the ToEEV between two subsequent payment (or measurement) dates is considered by many to be the appropriate outcome. However EFRAG observes that this is not the result of a link to the pattern of receipt or consumption of an identifiable asset or service.
- 3.20 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 a presumption that the services will be received on a straight-line basis over the vesting period.
- 3.21 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.
- 3.22 In the case of recurring payments such as annual levies, a question arises as to the relevant time horizon to accrue for a liability. The approach explored in the DP retains the view in the revised *Conceptual Framework* that neither economic compulsion nor 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

- 3.23 The fourth step applies to all ToEEV in scope that are not addressed by Steps 1 to 3. 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 should follow the recognition of the asset/liability under the requirements in IFRS Standards. Often, this will result in immediate recognition of the ToEEV cost/income.
- 3.24 Typically, this category will encompass transfers such as some one-off levies, penalties and fines, and donations.

Performance-related condition

- 3.25 The first step uses the notion of a performance-related condition.
- 3.26 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 International 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 grants 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 or some form of redress 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 those future economic benefits or service potential must be returned to the transferor.
- 3.27 The recipient of grants and similar benefits subject to conditions, as defined above, 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.
- 3.28 Some conditions are linked to the operations of the entity (e.g. receiving a grant to undertake 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.
- 3.29 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 under IFRS 15 is narrower than 'performance-related condition' for a ToEEV.
- 3.30 In this regard, EFRAG observes, that both the International Public-Sector Accounting Standard Board (IPSASB) and the US Government Accountant Standard Board (GASB) have ongoing projects exploring how a performance obligation approach could be applied to transactions with Governments, using the IFRS 15 definition as the starting point with appropriate modifications made for the public sector.
- 3.31 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

- 3.32 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

- 3.33 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

- 3.34 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.
- 3.35 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.
- 3.36 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

- 3.37 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.
- 3.38 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

- 3.39 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).

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Chapter 4: Practical issues

The role of uncertainty

- 4.1 The application of the second and third steps outlined in Chapter 3 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 Consumption or generation 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 approach explored in the DP 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 approach explored in the DP 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:
 - 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 the same for expense-generating transfers (such as levies) and income-generating transfers (such as grants)?
- 4.6 We will illustrate the first question with an example. Under the approach explored in the DP, an entity would accrue the liability for a levy recurring on an annual basis between two payment dates. Assume that the payment of the annual levy depends on the entity meeting a certain threshold of 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 paragraph 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 the scope of this project, this condition of 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 expense-generating transfers, the risk of reversal may be mitigated by the fact that they, for probably the most part, are not voluntary.
- 4.10 In relation to income-generating transfers, EFRAG understands that some would prefer asymmetrical recognition of assets and liabilities. This asymmetrical recognition would follow from the application of prudence. The implication of this asymmetry would be to maintain an essential role for control in relation to the recognition of an 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 IPSASB 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 in applying the requirements of IFRS 15 to ToEEV that are 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 may 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 approach 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.
- 4.13 Alternative a) is consistent with a view that neutrality in reporting provides the best information content. Alternative b) could be perceived as having attractive characteristics compared to neutrality in particular circumstances. For instance, if the recognition of an uncertain asset were material to the ability of the entity to continue as a going concern, alternative b) would ensure that all ToEEV assets were treated uniformly and therefore all entities with these assets were comparable,

Limitations and implications

- 4.14 EFRAG acknowledges that the application of the approach explored in the DP involves a certain degree of judgment.
- 4.15 The approach explored in the DP 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 transferred. This requires an unavoidable element of judgment.
- 4.16 For example, in Australia oil and gas companies pay a levy to finance the National Offshore Petroleum Safety and Environmental Management Authority. Given the nature of activities of the regulator, it may be argued that the entity paying the levy is receiving independent expert advice on their risk management plans. Alternatively, the regulations could have mandated that entities have these plans audited. If this interpretation is retained, the transfer would qualify for the second step 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 As noted in paragraph 2.17 and following, EFRAG excluded income taxes from the project scope. However, EFRAG considered the potential implications of including income tax in the scope. There does not seem to be any for annual reporting; but the pattern of recognition in interim periods would be different depending on whether income tax would be treated under the second or third Step.
- 4.18 The condition to apply the second Step is to assess that income tax is linked to an identifiable activity or of activities. However, the taxable basis is profit and it results from an aggregation of activities and transactions. It is not easy to allocate components of income tax to specific transactions – this would require to compute the tax consequences of each item.
- 4.19 If income tax was treated under the third Step, this would result in a straight-line allocation between two payment dates, like for a levy that is not linked to a specific underlying activity. However, this would result in changing the current requirements in IAS 34, under which income tax for interim periods is computed by applying the effective tax rates expected at year-end to the interim pre-tax income.

Chapter 5: Presentation and disclosures

- 5.1 Assets and liabilities recognised under the approach explored in the DP, especially under the second and third Step 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 judgments other than estimations made in applying accounting policies that have had the most significant effects on the amounts recognised.
- 5.3 Also, transfers under Step 2 may not occur on a regular basis or their size could change (compare a tax on investment disposals 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 occurred (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 degree and nature 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 2.12 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 Terms

- A1. The purpose of this glossary is to provide general and understandable explanations for the most important terms and definitions used in the DP. 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 Par. 3.6

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 <i>Income Taxes</i>); 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** – Exclusions from the project: 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 on commercial terms (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.

Approach explored in the DP

- IE 4. Since the transaction is voluntary and occurs on 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 – Exclusion from the project – Transfers with shareholders

Fact pattern

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

Accounting under current IFRS

- IE 6. According to IAS 20.10 the benefit of a government loan at a below-market rate of interest should be treated as a government grant. The loan shall be recognised and measured in accordance with IFRS 9 *Financial Instruments*. The benefit of the below-market rate of interest shall be measured as the difference between the initial carrying value of the loan determined in accordance with IFRS 9 and the proceeds received. The entity shall consider the conditions and obligations that have been, or must be, met when identifying the costs for which the benefit of the loan is intended to compensate.

Revised Conceptual Framework

- IE 7. The Conceptual Framework requires to distinguish changes in a reporting entity's economic resources and claim that result from that entity's performance and from other events or transactions such as issuing debt or equity instruments. Changes in an entity's economic resources and claims not resulting from financial performance are presented in the statement of changes in equity.
- IE 8. In the case of a loan from a parent to a subsidiary that pays interest at less than the market rate, the difference between the loan amount and the fair value (ie the shortfall for the parent company) could typically be considered as an increase in the cost of investment by the parent company and a capital contribution by the subsidiary.

Approach explored in the DP

IE 9. 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 10. A government charges an annual levy of 0.1% of total liabilities at the end of the reporting period. The levy is payable on 1st January of the following year. If the reporting period is longer or shorter than 12 months, the levy is increased or reduced proportionately.

IE 11. It is assumed that there is no separately identifiable asset or service received in exchange for the levy payment.

IE 12. The entity estimates that it will incur an amount of CU 1,000 for the reporting period ended 31 Dec.

Accounting under current IFRS

IE 13. 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 in the future.

IE 14. 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 15. The Revised Conceptual Framework defines a liability as 'a present obligation of the entity to transfer an economic resource as a result of past events'.

IE 16. 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 17. 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 18. Judgment is 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.

Approach explored in the DP

IE 19. 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 condition (Step 1) nor to an identifiable activity or set of activities (Step 2). For these transfers the approach 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.

IE 20. These are the journal entries that would apply for the entity's interim accounts at 30 June based on an estimated annual expense of CU 1,000:

CR Liability	500
DR Expense	500

Example 4 - Levies on bank transfers

Fact pattern

IE 21. The tax regulations in country C 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.

IE 22. In December 200Y, an entity purchases an asset from a foreign supplier for CU 1,000,000 with a deferred payment in January 200Y+1. After the bank transfer is processed the entity will be liable to a transaction tax of CU 1,000 (i.e. payable in February 200Y+1 assuming the bank transfer for asset purchase is processed in January).

Accounting under current IFRS

IE 23. 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. The levy is recognised when the obligating event takes place.

Revised Conceptual Framework

IE 24. 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 25. The Conceptual Framework does not further define the term ‘action and judgment 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.

Approach explored in the DP

IE 26. 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 that would impose any performance to the entity .
- 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).

IE 27. These are the journal entries that would apply for the year ended 200Y+1

Option 1: underlying activity is considered to be the purchase of the asset in December 200X

IE 28. The entity would recognise the purchased asset (with the corresponding vendor’s liability) as well as a 1,000 liability related to the future bank transfer tax (payable in January the next year):

DR Asset (purchased asset)	1,000,000
CR Liability (vendor’s deferred payment)	1,000,000
DR Expense (transaction tax))	1,000
CR Liability (transaction tax)	1,000

Option 2: the underlying activity is considered to be the purchase of the asset in December 200X

IE 29. No entries regarding the transaction tax as of Dec 31 200X. The transaction tax liability and expense are recognised in January 200Y+1 (same entries as above).

Example 5 - Capital grant

Fact pattern

IE 30. A Government provide a grant 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.

IE 31. The purchase price of the asset is CU 5,000 and grant amounts to CU 1,000.

Accounting under current IFRS

IE 32. 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'.

IE 33. 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 34. The Revised Conceptual Framework defines an asset as 'a 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.

Approach explored in the DP

IE 35. The grant is a voluntary transfer for the resource recipient and does not involve an exchange of equal value. The entity concludes that the transfer falls within the proposed scope.

IE 36. 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 all the conditions under the grant agreement.

IE 37. The approach would need to determine whether the grant is taken as a profit, or spread over the depreciation period for the asset (see alternatives considered in paragraph 3.14).

IE 38. These are the journal entries that would apply at the date of the purchase of the asset:

Option 1: grant taken as profit

DR Asset	5,000	
CR Cash	4,000	(ie 5,000 for the purchase of the asset less 1,000 grant)
DR Profit and loss	1,000	

Option 2: Grant spread over the depreciation period for the asset

DR Asset	5,000	
CR Cash		4,000
Deferred income		1,000

Example 6 - Income grant

Fact pattern

- IE 39. 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.
- Permutation A: 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.
 - Permutation B: 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.

Accounting under current IFRS

- IE 40. 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 41. 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 42. 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'.
- IE 43. Therefore, in the considered fact patterns:
- Under Permutation A*, 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.
 - Under Permutation B*, 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.

Revised Conceptual Framework

IE 44. 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 45. In the considered fact pattern:

- a) In the case of permutation A, grants received for past period are not repayable and it could be considered that the entity does not have a genuine condition to operate for three years.
- b) In the case of permutation B, 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.

Approach explored in the DP

IE 46. 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.

Permutation A

IE 47. 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, under-developed area. Under permutation A, the entity concludes that it fulfils its performance-related conditions over 3 years and recognise the grant income accordingly over that period.

IE 48. These are the journal entries that would apply over the 3-year period:

Year 1

CR Grant income 100

DR Cash 100

Year 2

CR Grant income 100

DR Cash 100

Year 3

CR Grant income 100

DR Cash 100

Permutation B

IE 49. Under permutation B, it could be argued that the entity has not fully complied with its conditions until the end of the third year. See above in paragraph 4.12 for a discussion on the role of uncertainty.

Example 7 – Research grant

Fact pattern

IE 50. 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 51. 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.

IE 52. The entities incurs projects costs of CU 1,000 and CU 300 in Year 1 and Year 2, respectively.

Accounting under current IFRS

IE 53. 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 54. 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 55. 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 56. 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 57. 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.

Approach explored in the DP

- IE 58. 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 59. Applying Step 1, the entity assesses whether the conditions contained in the grant qualify as a performance-related conditions.
- IE 60. The entity assesses that, under the grant agreement, no identifiable good or services are transferred (in this case, 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 61. 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 62. The receivable and grant revenue will be recognised as the entity fulfils its research obligations over the two-year period. In this specific case, this may 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.
- IE 63. These are the journal entries that would apply over the two year period:

Year 1

CR Grant income	500	(50% of project expenses of CU 1,000)
DR Receivable	500	

Year 2

CR Grant income	150	(50% of project expenses of CU 300)
DR Receivable	150	



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