EFRAG
European Financial Reporting Advisory Group

DRAFT ENDORSEMENT ADVICE AND EFFECTS STUDY REPORT ON IFRIC INTERPRETATION 21 *LEVIES*

INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS

Comments should be sent to commentletters@efrag.org by 2 September 2013

EFRAG has been asked by the European Commission to provide it with advice and supporting material on IFRIC Interpretation 21 *Levies* ('IFRIC 21' or 'the Interpretation'). In order to do that, EFRAG has been carrying out an assessment of IFRIC 21 against the technical criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from its implementation in the European Union (the EU) and European Economic Area.

A summary of IFRIC 21 is set out in Appendix 1.

Before finalising its two assessments, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record, unless the respondent requests confidentiality. In the interest of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

EFRAG's initial assessments summarised in this questionnaire will be amended to reflect EFRAG's decisions on Appendix 2 and 3.

1 Please provide the following details about yourself:

(a) Your name or, if you are responding on behalf of an organisation or company, its name:

Danish Bankers Association

(b) Are you a:

☒ Preparer ☒ User ☒ Other (please specify)

Our members are both preparers and users of financial statements

(c) Please provide a short description of your activity:

Association of Danish banks

(d) Country where you are located:

Denmark

(e) Contact details including e-mail address:

mat@finansraadet.dk

+45 33 70 10 24

2 EFRAG's initial assessment of IFRIC 21 is that it meets the technical criteria for endorsement. In other words, it is not contrary to the principle of true and fair view and it meets the criteria of understandability, relevance, reliability and comparability. EFRAG's reasoning is set out in Appendix 2.

(a) Do you agree with this assessment?

☒ Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

(b) Are there any issues that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of IFRIC 21? If there are, what are those issues and why do you believe they are relevant to the evaluation?

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3 EFRAG is also assessing the costs that are likely to arise for preparers and for users on implementation of IFRIC 21 in the EU and European Economic Area, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the assessment.

The results of the initial assessment of costs are set out in paragraphs 2 to 7 of Appendix 3. To summarise, EFRAG's initial assessment is that is there is no significant cost for the adoption of IFRIC 21 and that its benefit outweighs its cost.

Do you agree with this assessment?

☒ Yes ☐ No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

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4 In addition, EFRAG is assessing the benefits that are likely to be derived from IFRIC 21. The results of the initial assessment of benefits are set out in paragraph 7 of Appendix 3. To summarise, EFRAG's initial assessment is that users are likely to benefit from IFRIC 21, as it is likely to reduce the diversity of accounting in practice thus enhancing comparability and consistency of the information provided to all stakeholders.

Do you agree with this assessment?

☒ Yes ☐ No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG's endorsement advice?

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5 EFRAG's initial assessment is that the benefits to be derived from implementing IFRIC 21 in the EU and the European Economic Area as described in paragraph 4 above are likely to outweigh the costs involved as described in paragraph 3 above.

Do you agree with this assessment?

☒ Yes ☐ No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG's endorsement advice?

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6 EFRAG is not aware of any other factors that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on IFRIC 21.

Do you agree that there are no other factors?

☒ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this should affect EFRAG's endorsement advice?

APPENDIX 1
A SUMMARY OF IFRIC 21

Background

1 The IFRS Interpretations Committee ('the Interpretations Committee') received a request to clarify what the obligating event is that gives rise to the recognition of a liability for levies. In particular, the Interpretations Committee was asked to clarify how an entity should account for levies whose calculation is based on financial data relating to a period before the period containing the activity that triggers the payment of the levy.

2 The Interpretations Committee was informed that there was diversity in practice in the timing of recognition of the liability to pay a levy.

What does IFRIC 21 say?

3 The Interpretation addresses the accounting for a liability to pay a levy, which is defined as an outflow of resources embodying economic benefits imposed by governments on entities in accordance with legislation. It does not address the accounting for outflows such as fines, penalties, emission trading schemes and those within the scope of other standards (such as income taxes within the scope of IAS 12 *Income Taxes*). Also, entities should apply other Standards to decide whether the recognition of a liability to pay a levy gives rise to an asset or an expense.

4 The Interpretation clarifies that the obligating event that gives rise to a liability is the activity that triggers the payment of the levy, as identified by legislation. In addition it clarifies that:

(a) an entity does not have a constructive obligation to pay a levy that will be triggered by operating in a future period as a result of being economically compelled to continue to operate in that future period; and

(b) the going concern assumption does not imply that an entity has a present obligation to pay a levy that will be triggered by operating in a future period.

5 If the obligating event occurs over a period of time, the liability is recognised progressively over time. If the obligating event occurs at a point in time (such as a requirement to be in business at a certain date), the liability is recognised at a point in time.

6 An obligation to pay a levy that is triggered when a minimum threshold is reached shall be accounted consistently with the principles established in the Interpretation. For example, if a levy is triggered when an amount of revenue reaches a minimum threshold, the liability is recognised when the threshold is reached.

7 An entity shall apply the same recognition principles in the annual and interim financial statements.

When does IFRIC 21 become effective?

8 IFRIC 21 becomes effective for annual periods beginning on or after 1 January 2014. Earlier application is permitted. If an entity applies the Interpretation for an earlier period, it shall disclose that fact.

9 Changes in accounting policies resulting from the initial application of the Interpretation shall be accounted for retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

APPENDIX 2

EFRAG'S TECHNICAL ASSESSMENT OF THE INTERPRETATION AGAINST THE ENDORSEMENT CRITERIA

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on IFRIC Interpretation 21 Levies*.*

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity of contributing to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the technical criteria for the European endorsement, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

1 In evaluating IFRIC 21, EFRAG has considered four questions:

(a) Is there an issue that needs to be addressed?

(b) If there is an issue that needs to be addressed, is an Interpretation an appropriate way of addressing it?

(c) Is IFRIC 21 a correct interpretation of existing IFRS?

(d) Does the accounting that results from the application of IFRIC 21 meet the technical criteria for EU endorsement?

Is there an issue that needs to be addressed?

2 EFRAG understands that at present there is diversity in practice as to how entities account for the obligation to pay a levy. For example, there are different views about how an entity should account for levies whose calculation is based on financial data relating to a period before the period containing the activity that triggers the payment of the levy. EFRAG agrees that this diversity is undesirable and is an issue that needs to be addressed.

Is an Interpretation an appropriate way of addressing it?

3 An Interpretation is an appropriate way of addressing diversity in accounting practice if diversity arises because of factors other than inconsistencies between IFRSs. Furthermore, in EFRAG's view, Interpretations should not be used to address major issues.

4 EFRAG's assessment is that the diversity in practice that is the subject of IFRIC 21 does not arise from inconsistencies between IFRSs nor is a major issue. As such, EFRAG has concluded that an Interpretation is an appropriate way of addressing the uncertainties relating to how an entity should account for the obligation to pay a levy.

Is IFRIC 21 a correct interpretation of existing IFRS?

5 EFRAG considered whether IFRIC 21 is a correct interpretation of existing IFRS literature.

6 EFRAG notes that the scope of IFRIC 21 includes obligations to pay levies that are not uncertain in either timing or amount, and that are therefore not in scope of IAS 37. EFRAG has considered that references in IAS 37 (and IAS 34) are relevant for these obligations, as IAS 37 provides guidance on what an obligating event is that triggers the recognition of a liability, and this guidance in IAS 37 is independent of whether the liability is certain or uncertain in timing or amount.

7 EFRAG believes that IFRIC 21 is a technically correct and appropriate interpretation of existing IFRS as the consensus is consistent with:

(a) the current definition of a 'liability' in the Conceptual Framework, under which an essential characteristic of a liability is that the entity has a present obligation;

(b) the guidance in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* further elaborates on the definition of a liability as provided in the Conceptual Framework and specifies:

(i) the meaning of an 'obligating event', 'legal obligation' and 'constructive obligation'; and

(ii) the recognition principles for a provision in scope of IAS 37:

- a provision should be recognised only when an entity has a present obligation as a result of a past event;
- no provision is recognised for costs that need to be incurred to operate in the future (paragraph 18 of IAS 37); and
- it is only those obligations arising from past events existing independently of an entity's future actions that are recognised as provisions (paragraph 19 of IAS 37).

(c) IAS 34 *Interim Financial Reporting* which requires that the same recognition principles shall be applied in the annual financial statements and in the interim financial report. IAS 34 moreover states:

(i) a cost that does not meet the definition of an asset at the end of an interim period is not deferred in the statement of financial position either to wait future information as to whether it has met the definition of an asset or to smooth earnings over interim periods within a financial year (paragraph 30(b) of IAS 34);

(ii) costs that are incurred unevenly during an entity's financial year shall be anticipated or deferred for interim reporting purposes if, and only if, it is also appropriate to anticipate or defer that type of cost at the end of the financial year (paragraph 39 of IAS 34); and

(iii) an entity shall include explanatory comments about the seasonality or cyclicality of interim operations (paragraph 16A(b) of IAS 34).

8 Based on this, EFRAG agrees with the consensus reached by the Interpretation Committee that there is no constructive obligation to pay a levy that relates to the future conduct of the business, even if:

(a) it is economically unrealistic for the entity to avoid the levy if it has the intention of continuing in business;

(b) there is a legal requirement to incur the levy if the entity does continue in business; and

(c) it would be necessary for an entity to take unrealistic action to avoid paying the levy, such as to sell, or stop operating, property, plant and equipment.

9 EFRAG considered the argument that a constructive obligation may exist for a levy due at a point in time, when the only way to avoid payment would be to cease operations, a scenario that is usually perceived as merely theoretical. EFRAG noted that there are other recurring costs that an entity is certain to incur in the future under a going concern assumption (e.g. planned periodic maintenance), but there is a general understanding that these do not give rise to a present obligation to be recognised as noted in paragraph 7(b) above.

10 EFRAG considered that IFRIC 21 addresses only the accounting for a liability to pay a levy and it does not specify if the levy should be immediately recognised as an expense or an asset. Entities should apply other Standards to decide whether the recognition of a liability to pay a levy gives rise to an asset or an expense.

11 EFRAG also believes that the consensus reached by *the Interpretation Committee is consistent with the way the principles in IAS 37 have been applied to oth*er pronouncements such as IFRIC 6 *Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment.*

Does the accounting that results from the application of IFRIC 21 meet the technical criteria for EU endorsement?

12 EFRAG has considered whether IFRIC 21 meets the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that IFRIC 21:

(a) is not contrary to the principle of ‘true and fair view’ set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

(b) meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

13 EFRAG also considered, based only on evidence brought to its attention by constituents, whether it would be not conducive to the European public good to adopt IFRIC 21.

Relevance

14 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.

15 EFRAG considered whether IFRIC 21 would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

16 During the development of IFRIC 21 EFRAG maintained the view that the consensus is consistent with the principles of related IFRS requirements. Nevertheless, EFRAG believed that the application of the consensus might not always result in the most decision-useful financial information to users and that attention needed to be given to the underlying substance of the levy and not merely its legal form, i.e. the legal requirements on when and how levies become due are not necessarily the most significant feature from an economic point of view.

17 Particularly, when the legislation is developed in such a way as to identify a specific date/event that triggers the obligation to pay the levy and the levy is charged on a recurring basis (e.g. an annual basis), the levy is often regarded as a charge that relates to a period of time (i.e. annual period). Consequently, many believe that a progressive recognition of an expense regarding these levies would be better understood by users. Supporting arguments encompass that entities have no realistic possibility of avoiding the obligation and governments charge a number of taxes to meet annual budgetary objectives.

18 EFRAG recognised these concerns, and has therefore evaluated the consequences when a liability is recognised at a point in time and the entity concludes that it should be immediately expensed:

(a) in interim accounts: the interpretation is expected to have a potential impact on interim accounts in circumstances when levies are due at a point in time or after a threshold is met and the corresponding expense is recorded in the period in which the levy comes due, and not evenly throughout interim periods. Still, where levies would be material to the accounts, IAS 34 requires that proper disclosure be provided, so that users have access to relevant information; and

(b) in annual accounts: the interpretation is not expected to impact the relevance of the income statement in annual accounts, as recurring levies would be recognised once every year. Liabilities recognised in the balance sheet would reflect the conditions in which the obligation to pay the levy arises and the effect of possible instalment payments, reflecting the conditions in which the legislator has decided to design the levy. A significant levy becoming due between the end of the reporting period and the reporting date, if unrecognised in accordance with IFRIC 21, would be considered a non-adjusting event under IAS 10 *Events after the Reporting Period*. To the extent the levy becoming due would be material – for example a significant levy becoming due for the first time - IAS 10 would require disclosure of the nature of the event and an estimate of its financial effect, so that users have access to relevant information.

19 Therefore, EFRAG concluded that IFRIC 21, combined with the guidance in other Standards, will provide relevant information to users about an entity's obligations to pay levies, even though some may think that it is not done in the most effective manner.

20 EFRAG's overall initial assessment is that IFRIC 21 would result in the provision of relevant info*rmation; and therefore it satisfi*es the relevance criterion.

Reliability

21 EFRAG also considered the reliability of the information that will be provided by applying IFRIC 21. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

22 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.

23 The requirements and guidance in IFRIC 21 are closely aligned with the requirements of IAS 34 and IAS 37 and with the current *Conceptual Framework*. Therefore, in EFRAG's view, IFRIC 21 does not raise any new concern. Entities will be required to recognise a liability only when the obligating event has occurred – at that point in time the entity should possess all the information needed to determine the amount with precision, rather than rely on projections.

24 In addition, as the interpretation provides guidance on factors that indicate what the obligating event is, EFRAG concluded that the guidance will help reporting entities provide reliable information to users about an entities' obligations to pay levies.

25 EFRAG's overall initial assessment is that IFRIC 21 would not raise concerns about risk of error or bias; and therefore it satisfies the reliability criterion.

Comparability

26 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

27 EFRAG has considered whether IFRIC 21 results in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

28 EFRAG acknowledged that accounting for levies in accordance with current IFRS (IAS 34 and IAS 37) distinguishes between levies based on when and how the legislator has decided the levy comes due, even though those conditions make an insignificant economic difference in practice, for entities which operate on an ongoing basis.

29 Nevertheless, EFRAG considered that the Interpretation ensures comparability as:

(a) it eliminates divergence in practice and ensures that all entities subject to the same levy (i.e. entities in the same industry and jurisdiction) recognise the liability to pay in the same way; and

(b) it makes the accounting for levies consistent with the principles of related IFRS requirements (IAS 34 and IAS 37).

30 Therefore, EFRAG's overall initial assessment is that IFRIC 21 satisfies the comparability criterion.

Understandability

31 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.

32 To eliminate divergence in practice while requiring an accounting treatment for levies that some consider as being more relevant, the only viable and practical alternative would have been to provide an exception in IAS 34. EFRAG does not support introducing exceptions because they undermine the understandability of financial reporting and could lead to an application by analogy to other costs that are incurred unevenly during the year.

33 EFRAG concluded that the information that results from the application of IFRIC 21 is understandable because, as noted above in the assessment of the reliability criterion, IFRIC 21 is closely aligned with the requirements in IAS 37, IAS 34 and the principles in the *Conceptual Framework*.

34 Moreover, in EFRAG's view, IFRIC 21 does not introduce any new complexities that may impair understandability. Therefore, EFRAG's overall initial assessment is that IFRIC 21 satisfies the understandability criterion in all material respects.

True and Fair

35 EFRAG's initial assessment is that the information resulting from the application of IFRIC 21 would not be contrary to the true and fair view principle.

European public good

36 EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt IFRIC 21.

Conclusion

37 For the reasons set out above, EFRAG's initial assessment is that IFRIC 21 satisfies the technical criteria for EU endorsement and EFRAG should therefore recommend its endorsement.

APPENDIX 3

EFRAG'S EVALUATION OF THE COSTS AND BENEFITS OF THE INTERPRETATION

1 EFRAG has also considered whether, and if so to what extent, implementing IFRIC 21 *Levies* in the EU and the European Economic Area might result in incremental costs for preparers and/or users, and whether those costs are likely to be exceeded by the benefits to be derived from its adoption.

Cost for preparers

2 EFRAG has carried out an initial assessment of the cost implications for preparers resulting from IFRIC 21.

3 EFRAG notes that the guidance in IFRIC 21 does not require capturing or tracking new information as entities already collect this information for current accounting purposes. Similarly, EFRAG believes that there will be no need to implement significant new systems to allow them to account for levies in accordance with IFRIC 21. However, entities will incur in insignificant one-off costs in applying IFRIC 21 retrospectively. Those costs will depend on the extent to which their current accounting practices differ from requirements under IFRIC 21.

4 Overall, EFRAG's initial assessment is that IFRIC 21 will not result in increased costs to preparers, i.e., it is likely to be cost neutral.

Costs for users

5 EFRAG has carried out an initial assessment of the cost implications for users resulting from IFRIC 21 and it is not aware of any aspect of IFRIC 21 that will increase the costs users will incur in analysing the financial statements as a result of its adoption.

Benefits for preparers and users

6 EFRAG has carried out an initial assessment of the benefits for users and preparers resulting from IFRIC 21.

7 Overall, EFRAG's initial assessment is that users are likely to benefit from IFRIC 21, as the information resulting from it will remove diversity in practice and increase comparability between entities and therefore will enhance their analysis.

Conclusion

8 For the reasons set out above, EFRAG's initial assessment is there is no significant cost for the adoption of the IFRIC 21 and that its benefit outweighs its cost.

APPENDIX 4

DISSENTING OPINIONS

1 Two EFRAG TEG members dissent from recommending the endorsement of IFRIC 21 Levies.

PRINCIPLES ESTABLISHED IN THE CONSENSUS OF THE INTERPRETATION

2 One EFRAG TEG member believes that the accounting for many types of levies should follow the accrual concept such that the liabilities are recognised through the periods to which they relate.

3 This EFRAG TEG member considers that the rejection of the accrual concept so as to address diversity in practice and provide consistent information, as noted in paragraph BC14 of IFRIC 21 is not a sufficient justification for ignoring such matching. Accordingly, this EFRAG TEG member is of the opinion that application of the guidance can and will result in information that is neither reliable nor relevant.

LIMITATION OF THE INTERPRETATION TO THE RECOGNITION OF THE LIABILITY TO PAY A LEVY

4 IFRIC 21 defines when a levy must be recognised as a liability but scopes out the debit side of the entry; as stated in paragraph 3: 'The Interpretation does not address the accounting for the costs that arise from recognising a liability to pay a levy. Entities should apply other Standards to decide whether the recognition of a liability to pay a levy gives rise to an asset or an expense'.

5 One other EFRAG TEG member considers that IFRIC 21 does not allow an entity to determine whether the situations considered in this scope limitation are limited to the incorporation of levies in the cost of inventories (IAS 2 *Inventories*), tangible assets (IAS 16 *Property, Plant and Equipment*) and intangible assets (IAS 38 *Intangible Assets*) or allows periodic levies to be capitalised on their own in accordance with IAS 38. This EFRAG TEG member believes that that determination remains unspecified and open to divergence. This EFRAG TEG member considers it is therefore likely that further clarification will be required from the IFRS Interpretations Committee. IFRIC 21, according to him, will only achieve comparability for the balance sheet.

6 As a result, this EFRAG TEG member disagrees with the assessment made by EFRAG of the relevance and comparability criteria for those periodic levies that are due at a point in time and do not give rise to an asset. This is because, in his view, under the interpretation, the means used by a government to fund its budget (transaction, date or event triggers) will potentially affect the timing of the expense, thereby reducing the predictive value of interim results of an entity: disclosures will not compensate.

7 Similarly, the comparability of performance between entities operating in different sectors and/or jurisdictions will be hampered (or even be reduced), contradicting the expected benefits of international standards: according to this EFRAG TEG member, comparability of performance would have increased had levies been recognised as economically similar events (funding of the government budget) that should be accounted for similarly in profit or loss.