International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

10 September 2012

Dear Sir/Madam,

Re: Draft Interpretation on Levies Charged by Public Authorities on Entities that Operate in a Specific Market

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Draft Interpretation DI/2012/1 *Levies Charged by Public Authorities on Entities that Operate in a Specific Market*, issued by the IFRS Interpretations Committee on 31 May 2012 (the 'Draft Interpretation').

This letter is intended to contribute to the IFRS Interpretations Committee's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRIC Interpretation in the European Union and European Economic Area.

EFRAG acknowledges that the IASB received requests for guidance on the accounting for levies in the financial statements of the entity paying the levy and that subsequent outreach activities identified that there is diversity in practice in how entities account for the obligation to pay levies in a number of situations and the issue is widespread. However, EFRAG thinks that, before issuing any guidance on the topic, further consideration is needed to ensure that relevant information is provided to users.

In general, EFRAG acknowledges that the consensus is consistent with the principles in the Conceptual Framework and IAS 37. However, EFRAG is concerned that the consensus reached by the IFRS Interpretations Committee would not always reflect the economic substance of the levy, and not result in information aligned with users' needs, particularly in interim financial statements. Consequently, EFRAG encourages the IFRS Interpretations Committee to assist the IASB in addressing the accounting for payments to public authorities in a comprehensive way by taking into account the specific characteristics of such payments (e.g. non-exchange transactions) and the current requirements in IAS 12. The outcome should assist the decision on how to amend existing IFRS in order to provide more useful information to users in annual and interim financial reports.

Our detailed responses to the questions in the Draft Interpretation are included in the appendix to this letter.

If you would like to discuss our comments further, please do not hesitate to contact Filipe Alves or me.

Yours sincerely,

Françoise Flores
EFRAG Chairman

APPENDIX

EFRAG's responses to the questions raised in the Draft Interpretation

EFRAG's general comment

EFRAG believes that, before issuing any guidance on the topic, further consideration is needed to ensure that relevant information is provided to users.

In case the IFRS Interpretations Committee decides to finalise the Draft Interpretation, EFRAG has a number of comments and concerns illustrated below.

Question 1

The Draft Interpretation addresses the accounting for levies that are recognised in accordance with the definition of a liability provided in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Levies that are within the scope of the Draft Interpretation are described in paragraphs 3-5.

Do you agree with the scope proposed in the Draft Interpretation? If not, what do you propose and why?

EFRAG's response

EFRAG considers that the scope of the Draft Interpretation should be clarified in a number of respects to avoid significant divergent interpretations on the circumstances it is meant to apply. EFRAG also believes that the title of the Draft Interpretation may not properly reflect its scope.

EFRAG believes that any guidance on the topic should address the accounting for levies due only if a minimum revenue threshold is achieved

Scope in general

1 EFRAG understands, based on paragraphs 5(b) and BC5, that the scope of the Draft Interpretation intends to include the majority of payments to public authorities (e.g. property tax) and not merely levies charged in specific industries. We note that the title of the Draft Interpretation may suggest to some that the scope is narrower than the one intended by the Interpretations Committee. We would therefore recommend that the title be amended to reflect more properly the scope of the Draft Interpretation.

2 Paragraph 2 of the Draft Interpretation makes reference to the definition of a present obligation in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. EFRAG understands that the Draft Interpretation would apply to all levies that meet the definition of a liability in the Conceptual Framework, i.e. is not limited to the scope of IAS 37 (i.e. liabilities of uncertain timing or amount). For the avoidance of doubt, we believe that this should be made clearer in the drafting of paragraph 3 of the Draft Interpretation.

3 More in general, we believe that the term “levy” as well as “public authority” used in the Draft Interpretation may sometimes be ambiguous. For example, it may be questioned if mandatory rebates in the healthcare industry meet the definition of

'levy'. Therefore, EFRAG recommends clarifying the terms in the Draft Interpretation, in particular the term "levy" which may not be understood in the same way in all jurisdictions, especially those that rely on translated versions of IFRS.

Paragraph 4(b): levies that are due only if a minimum revenue threshold is achieved

4 EFRAG believes that any guidance on the topic should address the accounting for levies due only if a minimum revenue threshold is achieved, as we think that diversity in practice may continue to exist in these situations if no guidance is provided. Detailed rules-based scope exemptions risk creating artificial bright-line distinctions between levies that might be quite similar. For example, a levy payable on revenue in excess of a *de minimis* level would appear to be scoped out, while levies contingent on a minimum threshold not based on revenue (e.g. assets, liabilities, cash flows or, possibly, interest income) are in the scope, even if the Interpretations Committee failed to reach a consensus as to what is the obligating event under a threshold mechanism. The reason for the difference is not clear.

5 When developing the guidance, the IFRS Interpretations Committee should consider the treatment of thresholds and contingent payments in existing Standards (e.g. IAS 34) and latest developments within other projects.

Clarification issues

6 EFRAG believes that the wording of the Draft Interpretation should be clarified in a number of respects, as suggested below.

<u>Paragraph 4(a): income taxes that are within the scope of IAS 12 Income Taxes</u>

7 EFRAG agrees with the exemption in paragraph 4(a), as it prevents a scope conflict with IAS 12. However, we suggest removing the wording 'ie a net amount of revenues and expenses' as this is not a definition of taxable profit used in IAS 12.

<u>Paragraph 5(b): paid by entities that operate in a specific market</u>

8 Paragraph 5(b) of the Draft Interpretation states that a specific market can be, for example, a specific country, a specific region or a specific market in a specific country. As drafted, we believe that the criterion in paragraph 5(b) is redundant because 'specific market' is defined in such a broad manner as not to exclude any type of levy.

<u>Paragraph 5(c): levies which are non-exchange transactions</u>

9 Paragraph 5(c) of the Draft Interpretation states that only levies that are non-exchange transactions are within the scope of the interpretation. It further specifies that levies that result in the recognition of an (intangible) asset (e.g. a right to operate in a certain market) are outside the scope of the Draft Interpretation. This leaves unclear how an entity should deal with levies that are in effect multiple element transactions or provide certain benefits. For example, levies that fund deposit insurance schemes might result in benefits through lower costs of funding.

10 Furthermore, EFRAG is concerned that by referring to 'non-exchange transactions' the Draft Interpretation leaves it unclear when a levy should be expensed or capitalised as an (intangible) asset. We recommend including specific guidance in the Draft Interpretation to help assess when a levy is considered to be a non-exchange transaction. In absence of guidance, an entity could argue that a levy

provides it with a right to operate until the next payment is due, and therefore argue that the transaction is outside the scope of the Draft Interpretation.

Paragraph 5(e): calculation basis of the levy

11 Paragraph 5(e) of the Draft Interpretation states that levies are in the scope of the Draft Interpretation if they are calculated based on data for the current period or a previous period. EFRAG is concerned that this might be understood as meaning that fixed-fee levies (i.e. which are not based on data for the current period or previous period) are outside the scope of the interpretation, which we do not think should be the case. Therefore, EFRAG suggests amending the paragraph to explicitly state that fixed-fee levies are within the scope of the Draft Interpretation.

Question 2

The consensus in the Draft Interpretation (paragraphs 7-12) provides guidance on the recognition of a liability to pay a levy.

Do you agree with the consensus proposed in the Draft Interpretation? If not, why and what alternative do you propose?

EFRAG's response

EFRAG is concerned that the consensus reached by the IFRS Interpretations Committee would not always reflect the economic substance and not result in information aligned with users' needs, particularly in interim financial statements. Consequently, EFRAG encourages the IFRS Interpretations Committee to assist the IASB in addressing the accounting for payments to public authorities in a comprehensive way by taking into account the specific characteristics of such payments (e.g. non-exchange transactions) and the current requirements in IAS 12. The outcome should assist the decision on how to amend existing IFRS in order to provide more useful information to users in annual and interim financial reports.

12 EFRAG acknowledges that the consensus is consistent with the principles in the Conceptual Framework and IAS 37. However, EFRAG is concerned that the consensus reached by the Interpretations Committee would not reflect the economic substance and not result in information aligned with users' needs, particularly in interim financial statements.

13 EFRAG is concerned with the outcome of the Draft Interpretation in situations where levies are due only if the entity operates at the end of the annual reporting period or when reaching the threshold is considered the trigger event. In accordance with paragraph 12(a) of the Draft Interpretation an entity would not be able to anticipate the levy expense in the interim financial statements as the obligating event has not yet occurred. We are aware that this is in line with the Conceptual Framework (paragraph 4.50) since 'the application of the matching concept ... does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities'. However, in these situations we do not consider that the Draft Interpretation always result in decision-useful financial information in interim financial statements.

14 Similarly, EFRAG is concerned that when a levy is charged on a recurring basis at the start of the year, recognising always the full liability and expense at that point in time does not provide decision-useful information at all times.

15 EFRAG thinks that in a number of situations, even though the legislation refers to a specific date such as the beginning of the reporting period, the features of the levy (e.g. levy being charged annually) indicate that the levy relates to a period of time rather than a single date. We believe that attention needs to be given to its underlying substance and economic reality and not merely its legal form.

16 Consequently, EFRAG encourages the IFRS Interpretations Committee to assist the IASB in addressing the accounting for payments to public authorities in a comprehensive way by taking into account the specific characteristics of such payments (e.g. non-exchange transactions) and the current requirements in IAS 12. The outcome should assist the decision on how to amend existing IFRS in order to provide more useful information to users in annual and interim financial reports.

Question 3

Entities would be required to apply the Draft Interpretation retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Do you agree with the proposed transitions requirements? If not, what do you propose and why?

EFRAG's response

EFRAG agrees with the proposed transition requirements.

17 EFRAG generally agrees with full retrospective application of new Standards and Interpretations. In this specific case, EFRAG does not see any impediment to full retrospective application.