EFRAG
European Financial Reporting Advisory Group

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Directorate General for the Internal Market
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Dear Mr Faull

Adoption of IFRIC Interpretation 21 *Levies*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards we are pleased to provide our opinion on the IFRIC Interpretation 21 *Levies* ('IFRIC 21'), which was issued by the IASB on 20 May 2013. It was issued as a Draft Interpretation in May 2012 and EFRAG commented on that draft.

The objective of IFRIC 21 is to clarify what the obligating event is that gives rise to the recognition of a liability for levies.

IFRIC 21 becomes effective for annual periods beginning on or after 1 January 2014. Earlier application is permitted, however entities shall disclose that fact.

EFRAG has carried out an evaluation of the IFRIC 21. As part of that process, EFRAG issued its initial assessment for public comment and, when finalising its advice and the content of this letter, it took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

EFRAG supports IFRIC 21 and has concluded that it meets the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards in that it:

- is not contrary to the principle of 'true and fair view' set out in Article 4(3) of Council Directive 2013/34/EU; and

- 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.

For the reasons given above, EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt IFRIC 21 and, accordingly, EFRAG recommends its adoption. EFRAG's reasoning is explained in the attached 'Appendix - Basis for Conclusions'.

On behalf of EFRAG, I should be happy to discuss our advice with you, other officials of the EU Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely

Françoise Flores
EFRAG Chairman

APPENDIX 1
BASIS FOR CONCLUSIONS

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

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.

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

1 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 4(3) of Council Directive 2013/34/EU; 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.

2 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

3 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.

4 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.

5 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 allow a faithful representation of the transaction; 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.

6 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, although the legislation may often not make it clear whether the levy is intended to be related to entities' (1) future activities (in which case some believe that the entity should recognise an asset when the liability becomes due, and amortise it over the period until the next payment) or (2) past activities (in which case some believe that the liability, and related expense, should be accrued progressively over the period). 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.

7 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.

8 Finally, EFRAG notes that IFRIC 21 addresses only the accounting for a liability to pay a levy, and refers entities to other standards to assess whether the recognition of a liability to pay a levy gives rise to an asset or an expense.

9 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.

10 EFRAG's overall assessment is that IFRIC 21 would result in the provision of relevant information; and therefore it satisfies the relevance criterion.

Reliability

11 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.

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

13 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.

14 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.

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

Comparability

16 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.

17 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.

18 EFRAG acknowledged that accounting for levies in accordance with current IFRS (IAS 34 and IAS 37) results in different outcomes based on when and how the legislator has decided that the levies become due, although those conditions may, in some circumstances, make an insignificant economic difference in practice for entities which operate on an ongoing basis and the entity's ability to avoid the payment may not be practical.

19 Nevertheless, EFRAG considered that on balance the Interpretation aids 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).

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

Understandability

21 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.

22 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 generally 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.

23 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*.

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

True and Fair

25 EFRAG's 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

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

Conclusion

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

APPENDIX 2

DISSENTING OPINIONS

1 Bill Hicks and Nicolas de Paillerets dissent from recommending the endorsement of IFRIC 21 Levies.

PRINCIPLES ESTABLISHED IN THE CONSENSUS OF THE INTERPRETATION

2 Bill Hicks 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 Bill Hicks 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, he 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 Nicolas de Paillerets 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. Nicolas de Paillerets believes that that determination remains unspecified and open to divergence. He 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 liability side of the balance sheet.

6 As a result, Nicolas de Paillerets 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 Nicolas de Paillerets, 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.