

DRAFT COMMENT LETTER
Comments should be submitted by 22 August 2012 to
Commentletters@efrag.org

XX July 2012

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

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. Therefore, EFRAG thinks that specific guidance in this case will contribute to consistency in accounting for levies. Our detailed responses to the questions in the Draft Interpretation are included in the appendix to this letter.

In general, EFRAG acknowledges that the consensus is consistent with the principles in the Conceptual Framework and IAS 37. EFRAG believes that the Draft Interpretation should also address the accounting for levies due only if a minimum revenue threshold is achieved. Furthermore, EFRAG recommends that the IASB make clearer that the scope of the Draft Interpretation is very broad and includes within its scope the majority of payments to public authorities (e.g. property tax).

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

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?

Notes for EFRAG's constituents

- 1 *Paragraph 3 of the Draft Interpretation states that it addresses the accounting for levies that are recognised in accordance with the definition of a liability provided in IAS 37.*
- 2 *However, the scope of the Draft Interpretation is restricted in a number of ways. Paragraph 4 exempts from the scope certain payments an entity may be required to pay, as for example fines and levies that are due only if a minimum revenue threshold is achieved, and paragraph 5 requires levies in the scope to have a number of characteristics.*

EFRAG's response

EFRAG believes that the Draft Interpretation should also address the accounting for levies due only if a minimum revenue threshold is achieved. In addition, EFRAG considers that the scope of the Draft Interpretation should be clarified in a number of respects.

Scope in general

- 3 EFRAG understands, based on paragraphs 5(b) and BC5, that the scope of the Draft Interpretation is very broad and includes 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 the broad scope of the Draft Interpretation.

Question to EFRAG's constituents

- 4 Do you believe that the scope of the Draft Interpretation is too broad? Please explain.
- 5 Are there any levies to which the Draft Interpretation applies that you believe should be outside its scope? If so, please explain.

- 6 Paragraph 3 states that the Draft Interpretation addresses the accounting for levies recognised in accordance with the definition of a liability that is provided in IAS 37.

Levies Charged by Public Authorities on Entities that Operate in a Specific Market

- 7 EFRAG understands that the scope of the Draft Interpretation is not limited to provisions as defined IAS 37 (i.e. liabilities of uncertain timing or amount), but includes all levies that are recognised in accordance with a definition of a liability, even if they are outside the scope in IAS 37.
- 8 EFRAG believes that the wording of the Draft Interpretation should be clarified to make its intended scope clearer.
- 9 EFRAG considers that the Draft Interpretation should include a definition of the term 'levy' because the term is not understood in the same way in all jurisdictions; particularly, those that rely on translated versions of the IFRSs.

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

- 10 EFRAG believes that the Draft Interpretation should also 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. In addition, we believe that 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. Conversely, levies that rely on a minimum threshold other than revenue (e.g. assets, liabilities, cash flows or, possibly, interest income) are in the scope.
- 11 EFRAG does not see a conceptual reason why the rationale in paragraph BC8 of the Draft Interpretation would not also apply to levies due only if a minimum revenue threshold is achieved. That is, the generation of revenue prior to reaching the threshold is necessary, but not sufficient to create the obligation. Consequently, EFRAG believes that the Interpretations Committee should explain why this would not apply in the case of levies that are due only if a minimum revenue threshold is achieved.

Question to EFRAG's constituents

- 12 Do you believe (based on the principles in IAS 37) that for levies that are due only if a minimum revenue threshold is achieved, crossing the minimum revenue threshold is the obligating event? If so, do you believe that this results in useful information and achieves faithful representation?

Clarification issues

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

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

- 14 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.

Paragraph 5(b): paid by entities that operate in a specific market

- 15 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.

Paragraph 5(c): levies which are non-exchange transactions

- 16 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. For example, levies that fund deposit insurance schemes might result in benefits through lower costs of funding.
- 17 Furthermore, EFRAG is concerned that by referring to 'non-exchange transactions' the Draft Interpretation leaves it unclear whether a levy should be expensed or capitalised as an (intangible) asset. To clarify, an entity that believes that a levy provides it with a right to operate until the next levy payment is due, would consider that to be an (intangible) asset and would hence consider itself to be outside the scope of the Draft Interpretation. We believe that specific guidance should be included in the Draft Interpretation to help assess when a levy is considered to be a non-exchange transaction.

Question to EFRAG's constituents

- 18 Are there any levies that you believe give rise to an asset (e.g. a right to operate until the next levy payment is due) and that are hence outside the scope of the Draft Interpretation? If so, please provide details.

Paragraph 5(e): calculation basis of the levy

- 19 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 clarify 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?

Notes for EFRAG's constituents

- 20 *The Draft Interpretation clarifies that the obligation event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy as identified by the legislation.*
- 21 *In addition, paragraphs 8 and 9 of the Draft Interpretation note that:*

Levies Charged by Public Authorities on Entities that Operate in a Specific Market

- (a) an entity does not have a constructive obligation to pay a levy that will arise from operating in a future period as a result of being economically compelled to continue operating in that future period;*
 - (b) the going concern principle does not imply that an entity has a present obligation to continue operating in the future and therefore does not lead to the recognition of a liability at a reporting date for levies that will arise from operating in a future period.*
- 22 *Paragraph 11 of the Draft Interpretation clarifies that the liability to pay a levy that is within the scope gives rise to an expense.*
- 23 *The Draft Interpretation also clarifies that the liability to pay a levy is recognised progressively if the obligation event occurs over a period of time and that the same recognition principles shall be applied in the annual and interim financial statements. This means that when applying the requirements of IAS 34 Interim Financial Reporting, no liability should be recognised at the end of an interim reporting period if the obligating event has not yet occurred. For example, an entity should not recognise a liability and anticipate an expense in an interim reporting period if the present obligation arises only at the end of the annual reporting period. Equally, the levy expense should not be deferred if a present obligation to pay the levy exists at the end of the interim period.*
- 24 *The Interpretations Committee also discussed cases where the measurement of the levy is based on data from a previous reporting period. The Interpretations Committee noted that the activity undertaken in the previous period is necessary, but not sufficient, to create a present obligation. Therefore, the Interpretations Committee concluded that the obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation. In other words, the liability to pay a levy is recognised when the activity that triggers the payment of the levy, as identified by the legislation, occurs.*

EFRAG's response

EFRAG acknowledges that the consensus is consistent with the principles in the Conceptual Framework and IAS 37.

- 25 EFRAG acknowledges that the consensus is consistent with the principles in the Conceptual Framework and IAS 37.
- 26 Paragraph 19 of IAS 37 states that 'it is only those obligations arising from past events existing independently of an entity's future actions (ie the future conduct of the business) that are recognised as provisions'. Therefore, if an entity could avoid the payment of the levy by terminating its operations, EFRAG agrees that to be consistent with current IFRS literature no provision should be recognised for levies that relate to the future conduct of the business, even if, for example, an entity has a legal or contractual requirement to operate in the market in the future periods.
- 27 With reference to those cases where the measurement of the levy is based on the revenues generated in a prior period, EFRAG agrees that the earning of revenue should not necessarily lead to the recognition of a liability. EFRAG believes that this is consistent with paragraph 4.50 of the Conceptual Framework that states that 'the application of the matching concept under this Conceptual Framework does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.'

Question to EFRAG's constituents

- 28 Do you believe that the Draft Interpretation results in decision-useful financial information in annual financial statements and in interim financial statements (see paragraph 23 above)? Please explain why. If not, please indicate what you would recommend the IASB/ IFRS Interpretation Committee, along with your reasoning.

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?

Notes for EFRAG's constituents

- 29 *Paragraph A2 states that changes in accounting policies resulting from the initial application of the Draft Interpretation should be accounted for retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.*

EFRAG's response

EFRAG agrees with the proposed transition requirements.

- 30 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.