STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	**IAS 37 *Provisions, Contingent liabilities and Contingent Assets***
Paper topic	IFRIC Interpretation X *Levies*

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Introduction

1. In May 2012, the IFRS Interpretations Committee ('the Interpretations Committee') published a draft interpretation on the accounting for levies charged by public authorities on entities that participate in a specific market. The comment period ended on 5 September 2012. We have received 53 comment letters.

2. The purpose of this paper is:

   (a) to present a summary of the comments received on the draft interpretation; and

   (b) to analyse the comments received and discuss the next steps for the draft interpretation.

Structure of the paper

3. The structure of the paper is the following:

   (a) Comments received on the draft interpretation;

   (b) Staff analysis and recommendations.

Comments received on the scope of the draft interpretation

Scope exclusion: levies with minimum thresholds

4. All the respondents ask the Interpretations Committee to address the accounting for levies that are due if a minimum revenue threshold is achieved. Those levies were not included within the scope of the draft interpretation because the Interpretations Committee could not reach a consensus on the accounting for those levies.
5. Respondents also note that some levies are based on minimum thresholds other than revenues (such as the amount of assets, liabilities, levels of expense or other non-financial data such as emissions quantities). They ask whether these levies are included within the scope of the draft interpretation, because unlike levies based on a revenue threshold, they are not explicitly excluded from the scope of the draft interpretation.
6. Many respondents think that not dealing with levies with minimum thresholds represents a major shortcoming, because it significantly reduces the usefulness of the interpretation. They think that if the Interpretations Committee cannot reach a consensus on this topic, the final interpretation should not be published, because the absence of consensus underlines the difficulty of determining what the obligating event is. They think that the issue should be referred to the IASB in an attempt to resolve the issue before publishing any interpretation.
7. A few respondents think that the Interpretations Committee should, in the absence of consensus, indicate what is considered acceptable practice and should require disclosures that explain which method has been adopted (subject to materiality).
8. Lastly, a few respondents think that the requirements in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* are clear and that there is no obligating event until the threshold is reached.

Scope exclusion: non-exchange transactions

9. According to the draft interpretation, levies within the scope of the draft interpretation are non-exchange transactions (ie transactions in which the entity

does not receive any specific asset or service in direct exchange for the payment of the levy).

10. Some respondents ask why levies that give rise to assets are excluded from the scope. They do not think that this would affect the accounting for the liability. As a result, they think that the final interpretation should not discriminate between levies that are exchange transactions and those that are non-exchange transactions, because the issue of whether or not a corresponding asset is recognised is addressed in other IFRSs (and not IAS 37).

11. Some respondents think that it is not clear what a 'specific asset' refers to in the draft interpretation. They think that some levies paid by entities to operate in a specific market are similar to rights to operate and are therefore assets. Others think that entities receive some benefits in exchange for the payment of the levy. Those respondents ask whether those levies would be excluded from the scope of the draft interpretation.

12. A few constituents ask for application guidance in determining whether a levy is considered to be a non-exchange transaction. They note that the determination of whether a levy is a non-exchange transaction is highly subjective.

Scope exclusion: income taxes within the scope of IAS 12

13. All respondents agree that incomes taxes within the scope of IAS 12 *Income Taxes* should be excluded from the scope of the draft interpretation. Some respondents note that taxes based on a taxable profit within the scope of IAS 12 are described in the draft interpretation as being taxes based on a net amount of revenues and expenses. They suggest that this phrase should be removed, because they assert that it is not consistent with the wording in IAS 12. A few respondents ask for additional guidance in distinguishing income taxes from other levies.

Scope exclusion: fines and penalties

14. Some respondents ask the Interpretations Committee to clarify the distinction between levies and fines or penalties. For example, in a 'cap and trade' emissions quota scheme, in which the initial quotas are granted free of charge, payments

made to public authorities for emissions over the quota could be characterised as a fine/penalty or as a levy based on emissions over the quota.

Scope exclusion: emissions trading schemes

15. A few respondents think that emissions trading schemes should be excluded from the scope of the final interpretation. They think that the Interpretations Committee should not pre-empt the conclusions of the project on emissions trading schemes that the IASB indicated will form part of its future agenda.

Levies included within the scope: levies whose timing and amount is certain

16. The draft interpretation clarifies the accounting for levies that are recognised in accordance with the definition of a liability as provided in IAS 37. A few respondents ask whether the draft interpretation would only apply to levies that are within the scope of IAS 37 (ie liabilities of uncertain timing and amount) or would also apply to liabilities whose timing and amount is certain.

Levies included within the scope: scope too broad

17. Respondents question whether the scope of the draft interpretation is broader than initially intended. They understand that the scope of the draft interpretation could include all the levies and taxes that are not within the scope of IAS 12 or of IAS 19 *Employee Benefits*. If so, they think that the title of the draft interpretation should be changed.
18. Some constituents consider that the interpretation should cover all the levies, fees, taxes charged by public authorities other than income taxes within the scope of IAS 12 or taxes that fall in the scope of other IFRSs.
19. Others think that if the scope is broad, the Interpretations Committee should not issue the draft interpretation before conducting an analysis of the impacts upon the current accounting. For example, if emissions trading schemes are within the scope of the draft interpretation, it would require a liability to be recognised as the emissions are made. It would therefore change current practice for those

companies that choose to recognise a liability on a proportionate basis over the course of the compliance period.

Levies included within the scope: characteristics listed in paragraph 5 of the draft interpretation

20. Most of the respondents think that the terms 'levy' and 'public authority' should be defined, rather than giving a list of characteristics that levies in the scope of the draft interpretation should meet. They note that the term 'public authority' should be interpreted consistently with the definition of a government provided in IAS 20 A*ccounting for Government Grants and Disclosure of government Assistance* and IAS 24 *Related Party Disclosures*.

21. Most of the respondents think that the criteria listed in paragraph 5 are not sufficiently clear. They think that the scope of the interpretation should be clarified on the following aspects:

    (a) According to paragraph 5(b), levies within the scope of the interpretation are paid by entities that operate in a specific market as identified by the legislation. Respondents think that the notion of 'specific market' is confusing and is not useful. A levy, by definition, is put in place by a public authority and applies to a specific jurisdiction. Respondents ask whether the intention of the Interpretations Committee is to exclude certain types of levies from the scope of the interpretation.

    (b) According to paragraph 5(c), levies within the scope of the interpretation are calculated based on data for the current period or previous period. Respondents question whether levies with a fixed amount to be paid or levies based on non-financial variables are excluded from the scope.

IFRIC 6

22. Some respondents think that the Interpretations Committee should clarify interactions between the scope of IFRIC 6 *Liabilities arising from Participating in*

a Specific Market-Waste Electrical and Electronic Equipment and the scope of the final interpretation. Some respondents think that liabilities within the scope of IFRIC 6 should be dealt with in the final interpretation as one case among others. Others think that levies within the scope of IFRIC 6 should be excluded from the scope of the draft interpretation.

Comments received on the consensus of the draft interpretation

Date of recognition of the liability

23. Half of the respondents agree that the clarifications provided in the consensus regarding the accounting for the liability to pay a levy are consistent with the requirements in IAS 37.

24. The other half of the respondents think that the accounting proposed in the draft interpretation does not reflect the substance of the transaction and, as a result, would not lead to useful information for users of financial statements. However, most of the respondents that disagree with the proposed accounting broadly acknowledge that the consensus of the draft interpretation is a technically correct analysis of how the requirements in IAS 37 should be applied to levies. The other respondents that disagree (mostly financial institutions) think that the clarifications provided in the consensus are not consistent with the requirements in IAS 37 (see detailed comments below).

Substance over form

25. Although the consensus is broadly considered to be a technically correct analysis of how IAS 37 should be applied to levies, half of the respondents think that the draft interpretation does not reflect the substance of the transaction and, as a result, would not lead to useful information for users of financial statements. In particular, those respondents disagree with the proposed accounting for a levy that is recognised at a point in time at the end of the year. In such situations, the entity would not be able to accrue the levy expense in previous interim periods. They note that, according to the draft interpretation:

(a) the liability is recognised at a point in time if the obligating event (ie the activity that triggers the payment of the levy) occurs at a point in time;

(b) the debit side of the liability is an expense, unless the entity paying the levy receives a specific asset in direct exchange for the payment of the levy; and

(c) the same recognition principles shall be applied in the interim financial statements as are applied in the annual financial statements.

26. As a result, they understand that a liability and an expense are recognised at a point in time for levies that are triggered at a point in time (such as levies that are triggered if the entity operates on a specific date). They think that this outcome in profit or loss is not a fair representation of the economic effects of the levies and does not give useful information to users, especially for annual recurring levies. For annual recurring levies, those respondents think that the levy expense should be recognised progressively in profit or loss over a one-year period to reflect the economic substance and to provide useful information to users.

27. They note that the predominant economic function of a recurrent levy is to raise funds to finance the public authority for a specific period (generally a year) on a recurring basis. In many instances, the obligating event that triggers the payment of the levy is set for administrative convenience and is a non-substantive or formal condition (such as being in business on a specific date). They think that the substance of many levies is that it is an annual charge of the entity in respect of a specific period similar to annual licences or fees. This charge should be reflected in the financial statements by an even pattern of expense recognition over the period covered by the levy. As a result, those respondents think that the draft interpretation is focused on the legal form of the levy rather than on the underlying substance.

Comments received from some financial institutions

28. Some financial institutions think that economic compulsion to continue to operate in a future period, and the legal requirement to incur the levy if the entity does continue in business, constitute sufficient grounds for concluding that a constructive obligation to pay a levy exists, because the entity has no realistic

alternative but to pay the levy. The past event to support the constructive obligation should be the fact that the entity has operated, for example, as a bank for numerous years preceding the current financial year and continues to do so in the current year.

29. Others note that entities that pay levies such as described in Example 3 in the draft interpretation are unable to avoid the liability without incurring other more substantial costs. They also note that the banking sector is highly regulated and that banks have contractual obligations that mean a long period of unwind or run-off would be required. Furthermore, the regulatory oversight in the sector is such that a bank would not be able to make a unilateral decision to withdraw from the market (ie withdrawal would require regulatory approval and support). They also note that a bank cannot actually continue in operation as a going concern without paying the levy.

Debit side of the liability

30. Some respondents note that IAS 37 only addresses the recognition and measurement of provisions. It does not address the pattern of expense recognition. IAS 37 does not prohibit nor require capitalisation of the costs recognised when a provision is made. Other Standards specify whether expenditures are treated as assets or expenses. Those respondents think that the final interpretation should only address the recognition of the liability to pay a levy and should refer to other IFRSs regarding the accounting for the debit side of the liability. Furthermore, respondents note that the request that the Interpretations Committee received was to provide guidance on the timing of recognition of liabilities to pay levies.

31. Other respondents think that the debit side of the liability should be recognised as an asset in the following instances:

    (a) Some think that the entity paying the levy receives services from the public authority (even if those services are not identifiable or are not received directly in exchange for the payment of the levy). They think that the debit side of the liability is a prepaid expense. For annual recurring levies, they think that the expense should be recognised progressively over the year as the services are rendered by the public authority. For example, property taxes are paid in exchange for services (such as access to water, sewers and fire service). Bank levies could be viewed as providing access to services of the government such as the oversight of a regulator and access to funding from the central bank.

(b) Others think that the levy paid might be similar to a licence to operate granted by the public authority and that it meets the definition of an intangible asset in IAS 38 *Intangible Assets*. They think that for annual recurring levies the asset should be amortised over a one-year period.

(c) Other respondents think that a levy cost that is associated with an activity performed in more than one interim period should be allocated to the other interim periods through the use of accruals or deferrals. They think that IAS 34 *Interim Financial Reporting* and the interim accounting should be amended.

Capitalisation of the expense in an asset

32. Some respondents note that, according to the draft interpretation, liabilities that are within the scope of the draft interpretation give rise to an expense. They think that this requirement would contradict other IFRSs when the levies are an incidental cost of acquiring other assets, such as in the following cases:

(a) levies that meet the definition of transaction costs that are attributable to the acquisition of a financial instrument that generate interest income (see paragraph AG13 of IAS 39 *Financial Instruments: Recognition and Measurement*); and

(b) levies that are capitalised in the cost of an asset in accordance with IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment* and IAS 38, such as import duties or stamp duties on property acquisitions.

Interim accounting

33. The draft interpretation clarifies that a levy is accounted for in the interim period in which it is triggered. While this conforms to the 'year to date' basis in IAS 34, respondents think that it is not clear how this is consistent with existing examples in IAS 34 relating to the treatment of employer payroll taxes and contingent lease payments (Illustrative Examples B1 and B7).

34. Some respondents (mainly financial institutions) point out that comparability between European and US financial institutions is compromised. US entities can defer or allocate certain levies in their interim financial statements (see Topic 270-10 *Interim Reporting-Overall* in the *FASB Accounting Standards Codification*®). Consequently, US GAAP appears to be different from IFRS for interim reporting. They think that entities will have to provide further explanation to investors.

Agenda request to the IASB to deal with the accounting for levies in a specific project

35. Some respondents that disagree with the draft interpretation are not convinced that the debit side of the liability to pay a levy meets the definition of an asset in the current IFRS literature or that the interim accounting should be amended.

36. However, they think that non-reciprocal transactions in general, and government levies in particular, should not be within the scope of IAS 37. They think that levies paid to public authorities should be accounted for under specific requirements that reflect the economic substance of levies. They think that the Interpretations Committee should not issue the draft interpretation but should instead ask the IASB to deal with the accounting for levies as part of a specific project.

37. They note that other Standards in the IFRS literature do not conform to the definition of a liability as used in IAS 37 and that they allocate charges on a systematic basis over reporting periods.

    (a) Some respondents think that the principles developed in IAS 12 and in IAS 34 on income taxes should be applied by analogy to the accounting for levies within the scope of IAS 37.

(b) Some respondents point to the accounting for non-vested share-based payments in IFRS 2, the recognition of non-vested pension rights in IAS 19 or the accounting for bonuses, contingent lease payments and employer's payroll taxes in IAS 34 (Appendix B).

(c) Some respondents point to the accounting for grants in IAS 20). Grants received from public authorities are recognised in profit or loss over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate (even if no conditions are attached to the grant).

(d) Other respondents think that the IASB should address this issue as part of a project on the Conceptual Framework or on liabilities.

38. Some respondents also note that the fact that the Interpretations Committee could not reach a consensus for levies with a minimum threshold indicates that determination of the obligating event is far from clear-cut and that a more substantial pronouncement than an interpretation is required.

Disclosures

39. Some respondents ask for additional disclosures. They note that following the principles in the consensus, no liability would be recognised in interim financial statements for levies whose obligating event occurs after the end of the interim period. They think that disclosure of the likely amount to be paid should be provided in the interim financial statements.

Comments received on the transition requirements of the draft interpretation

40. All the constituents agree with the transition requirements proposed in the draft interpretation.

Staff analysis and recommendations

41. Our analysis of the comments received is discussed in detail below. The conclusions drawn from this analysis are the following:

   (a) the final interpretation should address the accounting for levies with minimum thresholds;

   (b) the final interpretation should address the accounting for levies that are within the scope of IAS 37 (including levies whose timing and amount is certain);

   (c) the final interpretation should address the accounting for levies, irrespective of whether those levies are analysed as exchange transactions or not;

   (d) the final interpretation should not address the accounting for liabilities arising from emissions trading schemes;

   (e) the term 'levy' should be defined in the final interpretation;

   (f) the final interpretation should only provide guidance on the accounting for the liability to pay a levy in annual financial statements (ie it should refer to other IFRSs with regard to the accounting for the debit side of the liability and interim accounting);

   (g) the Interpretations Committee should confirm the guidance provided in the consensus of the draft interpretation regarding the accounting for the liability to pay a levy;

   (h) further impact analysis of the final interpretation on the accounting for levies is not needed;

   (i) the final interpretation should not require additional disclosures specific to levies;

   (j) the Interpretations Committee should not propose to introduce specific requirements regarding levies in IAS 34; and

   (k) the Interpretations Committee should ask the IASB to consider the issues regarding the accounting for levies when developing the definition and recognition criteria for a liability in its project on the Conceptual Framework.

The final interpretation should address the accounting for levies with minimum thresholds

42. All the respondents ask the Interpretations Committee to address the accounting for levies that are due if a minimum threshold is achieved. We agree with the constituents that not addressing levies with minimum thresholds reduces the usefulness of the interpretation. We also agree with the respondents that the absence of consensus on this issue underlines the difficulty of determining what the obligating event is. As a result, we think that the Interpretations Committee should rediscuss the accounting for levies with minimum thresholds. We note than in order to reach a consensus on this issue, the Interpretations Committee would have to determine:

    (a) whether the threshold issue is a recognition issue or a measurement issue; and

    (b) whether the accounting should be the same for all types of thresholds (such as thresholds based on revenues, assets or liabilities).

43. If the Interpretations Committee agrees to rediscuss the accounting for levies with minimum thresholds, we would present a paper at the next meeting summarising the past discussions of the Interpretations Committee and the IASB. We note that the Interpretations Committee consulted the IASB on this issue and that the IASB expressed support for recognising in the annual financial statements levies subject to a revenue threshold progressively as the entity makes progress towards the revenue threshold provided it is probable that the threshold will be met.

44. Some respondents think that the Interpretations Committee should not issue an interpretation if it cannot reach a consensus on this issue. We think that the final interpretation should be issued even if it does not address levies with minimum thresholds. We think that it would still reduce diversity in practice.

45. Lastly, we think that if the Interpretations Committee excludes levies with minimum thresholds from the scope of the draft interpretation, it should be made

clear that all the levies with minimum thresholds are excluded (and not only levies with minimum **revenue** thresholds).

Questions for the Interpretations Committee on the threshold issue
1. Does the Interpretations Committee agree to rediscuss in a future meeting the accounting for levies with minimum thresholds?
2. Does the Interpretations Committee think that a final interpretation should be issued even if it does not address the accounting for levies with minimum thresholds?
3. Assuming that the final interpretation does not address the accounting for levies with minimum thresholds, does the Interpretations Committee agree that the scope should exclude all levies with minimum thresholds (and not only levies with minimum **revenue** thresholds)?

The final interpretation should address the accounting for levies that are within the scope of IAS 37 (including levies whose timing and amount is certain)

46. Most of the respondents ask to clarify the scope of the draft interpretation. They understand that the scope could include all the levies other than income taxes. They question whether the scope is broader than initially intended.

47. We note that the Interpretations Committee (then named the IFRIC) observed in an agenda decision published in March 2006 that any taxes that are not within the scope of IAS 12 are within the scope of IAS 37. The Board also confirmed during its February 2012 meeting that levies that are not based on taxable profits should be accounted for in accordance with IAS 37, and not IAS 12. Consequently, we think that the final interpretation should address the accounting for levies that are within the scope of IAS 37 (ie those that are not addressed in other IFRSs). As a result, the scope of the draft interpretation would exclude income taxes within the scope of IAS 12 or employee benefits (such as social security contributions) within the scope of IAS 19.

48. It should be noted that IAS 37 addresses the accounting for provisions. A provision is defined in IAS 37 as a liability of uncertain timing and amount.

Consequently, some respondents note that liabilities to pay levies whose timing and amount is certain are not provisions and are therefore not within the scope of IAS 37. We note that IAS 37 provides guidance on when to recognise a liability of uncertain timing and how to measure a liability of uncertain amount. Arguably, such guidance is not needed when the timing of a liability is known and when the amount of a liability is known. Although such guidance is not needed, we do not think that the accounting for a liability of certain timing and amount should differ from that which would be determined by applying IAS 37. We think that the same recognition requirements apply to provisions and to liabilities of certain timing and amount (because provisions are liabilities). As a result, we think that the interpretation should also address levies whose timing and amount is certain. We think that this should be made clear in the final interpretation.

49. Finally, we note that the Interpretations Committee tentatively decided that IFRIC 6 should be kept, because it provides useful information on the accounting for waste management under the EU directive on WE&EE. Consequently, we recommend that the scope of the final interpretation should exclude waste management costs that are within the scope of IFRIC 6. We do not think that this would cause any problems because the consensus in IFRIC 6 is consistent with the guidance provided in the draft interpretation regarding the recognition of a liability to pay a levy.

The final interpretation should address the accounting for levies, irrespective of whether those levies are analysed as exchange transactions or not

50. According to the draft interpretation, levies within the scope of the draft interpretation are non-exchange transactions. Some respondents ask why levies that give rise to assets are excluded from the scope. They do not think that this would affect the accounting for the liability. Other respondents note that the determination of whether a levy is a non-exchange transaction is highly subjective.

51. We agree with the constituents that the interpretation should address the accounting for all levies, irrespective of whether those levies are analysed as exchange transactions or non-exchange transactions, because we do not think that

whether or not the levy is paid as part of an exchange transaction affects the accounting for the liability to pay the levy. The fact that the levy is paid as part of an exchange transaction only affects the accounting for the debit side of the liability.

52. Furthermore, as explained in detail below, we propose that the draft interpretation should only provide guidance on the accounting for the liability to pay a levy. Consequently, we think that this distinction between exchange transactions and non-exchange transactions is meaningless.

The final interpretation should not address the accounting for liabilities arising from emissions trading schemes

53. We note that the IASB added a project on emissions trading schemes to its agenda in October 2005. The IASB reactivated work on the project in December 2007. Among the reasons for adding the topic to the agenda, the IASB noted that there was a risk of diverse accounting practices for such schemes following the withdrawal of IFRIC 3 *Emission Rights*. The IASB has made tentative decisions on some of the main issues in the project. In November 2010, the IASB decided to defer discussions. However, in May 2012, the IASB decided to add the project to its research agenda.

54. We think that the accounting for liabilities arising from emissions trading schemes would be better addressed in a comprehensive project that discusses all the recognition and measurement issues related to an emissions trading scheme (including the recognition of assets and liabilities when the entity receives emission allowances from the scheme administrator). We also think that the Interpretations Committee should not pre-empt the conclusions of the IASB on this topic. As a result, we do not think that the final interpretation should address the accounting for liabilities arising from emissions trading schemes.

The term 'levy' should be defined in the final interpretation

55. We agree with the constituents that the final interpretation should give a clear definition of the terms 'levies' and 'public authority', rather than giving a list of characteristics that the levies in the scope of the interpretation should meet.

56. We note that the term ‘government’ is used in IAS 20 and IAS 24. We suggest using the word ‘government’ in the draft interpretation, rather than the word ‘public authority’. We also suggest using the definition of the term ‘government’ provided in IAS 20 (paragraph 3) and in IAS 24 (paragraph 9). As a result, the term ‘government’ would refer to governments, government agencies and similar bodies whether local, national or international.

57. For the purposes of the interpretation, levies would be defined as transfers of resources to governments, in accordance with laws and/or regulations, established to provide revenue to the government, other than:

(a) levies that are within the scope of other IFRSs or other interpretations (such as income taxes within the scope of IAS 12, employee benefits within the scope of IAS 19 or waste management costs within the scope of IFRIC 6);

(b) fines or other penalties imposed for breaches of the laws or regulations; and

(c) payments made by an entity in accordance with a contract concluded between a government and that entity.

Consequently, the list of characteristics provided in paragraph 5 of the draft interpretation would be removed.

58. Some respondents note that taxes based on a taxable profit within the scope of IAS 12 are described in the draft interpretation as being taxes based on a net amount of revenues and expenses. They suggest that this sentence should be removed, because it is not consistent with the wording in IAS 12. We observe that the Interpretations Committee specified in two agenda decisions (published in March 2006 and May 2009) that the term ‘taxable profit’ implies a notion of a net rather that a gross amount. Consequently, we think that:

(a) the scope of the final interpretation should refer to income taxes as taxes based on a taxable profit; and

(b) the Basis for Conclusions of the final interpretation should mention the existence of the two agenda decisions (published in March 2006 and May 2009).

59. We do not think that there is a need to further clarify the distinction between levies and income taxes or levies and fines because we think that the clarifications provided above are sufficient. Entities must apply judgement to determine whether a levy is an income tax or is a fine.

60. Finally, we think that the title of the final interpretation should be changed to better reflect the scope of the final interpretation. We propose the following title for the interpretation: Levies.

Questions for the Interpretations Committee on the scope
4. Does the Interpretations Committee agree that the final interpretation should address the accounting for levies that are within the scope of IAS 37 (including levies whose timing and amount is certain), irrespective of whether those levies are exchange transactions or not?
5. Does the Interpretations Committee agree to exclude from the scope of the final interpretation liabilities arising from emissions trading schemes and WE&EE liabilities that are within the scope of IFRIC 6?
6. Does the Interpretations Committee agree with the definition of the terms 'levy' and 'government' provided in the section above?
7. If the Interpretations Committee disagrees with the broad scope for the interpretation proposed above, and instead thinks that the scope of the draft interpretation should be narrowed, what are the characteristics of levies that the Interpretations Committee thinks should be included within the scope of the final interpretation?

The final interpretation should only provide guidance on the accounting for the liability to pay a levy in annual financial statements

61. We think that the final interpretation should only provide guidance on the accounting for the liability to pay a levy in accordance with the requirements in IAS 37. The initial request of the submitter was about the timing of recognition of a liability to pay a levy. We think that the final interpretation should only refer to other IFRSs with regard to the accounting for the debit side of the liability and interim accounting. We observe that IAS 37 only deals with the recognition and

measurement of provisions. It does not specify whether expenditures are treated as expenses or as the cost of assets. These issues are addressed in other Standards (such as in IAS 38). This means that when a liability is recognised (and only when the liability is recognised), an asset should also be recognised if the expenditure incurred meets the definition of an asset in accordance with other IFRSs or the Conceptual Framework. We think that determining whether the entity paying the levy receives an asset in exchange for the payment of the levy is a matter of judgment, and we do not think that the interpretation needs to deal with this issue. We think that it was not the Interpretations Committee's intention to change the accounting for assets and expenses. Similarly, we think that the final interpretation should only refer to IAS 34 for interim accounting. As a result, we think that the guidance included in the draft interpretation relating to assets or expense recognition is not needed.

62. Lastly, we think that it should be made clear that the requirements in the final interpretation do not prevent an entity from capitalising a levy as part of the cost of an asset when another IFRS requires so.

The Interpretations Committee should confirm the guidance provided in the draft interpretation regarding the accounting for the liability to pay a levy

63. We note that half of the respondents agree with the consensus in the draft interpretation. Among the other half of the respondents who disagree with the consensus, most of them acknowledge that the consensus is a correct technical interpretation of the requirements in IAS 37. However, those respondents think that the draft interpretation does not provide a fair representation of the economic effects of levies when the liability and the corresponding expense are recognised at a point in time.

64. Although we are sympathetic to the view that the accounting for levies should reflect what some consider to be the substance of the transaction (ie a levy is a charge associated with a specific period and not a charge triggered on a specific date), we do not think that the Interpretations Committee should answer the constituents' concern by changing the accounting for the liability to pay a levy. We note that levies (other than income taxes within the scope of IAS 12 or taxes

within the scope of IAS 19) should currently be accounted for in accordance with the requirements in IAS 37 and we still think that the proposed accounting for the liability in the consensus of the draft interpretation is consistent with the requirements in IAS 37.

65. We think that the respondents' concerns are mostly related to the accounting for the debit side of the transaction and the expense recognition pattern in annual and interim financial statements. If the Interpretations Committee agrees to limit the guidance provided in the final interpretation to the accounting for the liability to pay a levy in accordance with the requirements in IAS 37, we think that this would alleviate some of the respondents' concerns, because entities would have to apply their judgement when determining whether the debit is an asset or an expense in accordance with the Conceptual Framework and other IFRSs.

66. Some of the respondents think that when an entity is not able to stop operating or to withdraw from a market, then the entity has a constructive obligation to pay the levy that will be triggered in the future. For example, the entity may operate in a regulated market and may not be able to stop operating without a long period of run-off, or the entity may have a contractual requirement to operate in the future because of the existence of a purchase or sale contract, or of a concession arrangement.

67. We disagree with this argument. We note that if this rationale were to be applied, a lot of future expenditures would be recognised as liabilities (and not only the future expenditures that need to be incurred in the immediate future period, but presumably the future expenditures that need to be incurred in several future periods). Indeed, in many cases, entities have no realistic alternative but to pay expenditures to be incurred in the future. However, we do not think that all these future expenditures meet the definition of a liability as provided in IAS 37. This is because IAS 37 (paragraphs 18 and 19) states that:

(a) no provision is recognised for costs that need to be incurred to operate in the future; and

(b) it is only those obligations arising from past events existing independently of an entity's future conduct of its business that are recognised as provisions.

68. The Interpretations Committee discussed this issue during the deliberations for the draft interpretation and concluded that these paragraphs of IAS 37 disallow certain provisions that might otherwise be recognised. We think that the Interpretations Committee should therefore reaffirm in the consensus of the draft interpretation that no liabilities are recognised for expenditures that will be incurred as a result of future operations, even if the entity has a contractual or legal requirement to continue to operate in the future and a near certainty that it will incur those expenditures. Similarly, there is no constructive obligation to pay a levy that relates to the future conduct of the business.

69. As a result, we think that:

(a) the accounting for the liability to pay a levy should be consistent with the requirements in IAS 37; and

(b) the clarifications made in the consensus regarding the date of recognition of the liability should be kept, subject to minor drafting amendments. In particular, the clarifications made in paragraphs 7-10 of the draft interpretation regarding the definition of the obligating event, the notion of 'constructive obligation' and the going concern principle, should be kept.

Questions for the Interpretations Committee on the accounting

8. Does the Interpretations Committee agree that the final interpretation should only provide guidance on the accounting for the liability to pay a levy in annual financial statements and refer to other IFRSs with regard to the accounting for the debit side of the transaction and interim accounting?

9. If not, does the Interpretations Committee want to rediscuss in a future meeting the accounting for the debit side of the liability and/or the accounting in the interim financial statements?

10. Does the Interpretations Committee agree to confirm the guidance provided in paragraphs 7-10 in the draft interpretation regarding the accounting for the liability to pay a levy (subject to minor drafting amendments)?

Further impact analysis of the final interpretation on the accounting for levies is not needed

70. A few respondents think that the Interpretations Committee should conduct an impact analysis of the interpretation on the current accounting for levies. It should be noted that outreach activities to National Standard Setters were performed in June 2011. The Interpretations Committee reviewed a summary of views received from National Standard Setters and noted that the issue is widespread and that there is diversity in practice.

71. We acknowledge that the scope of the final interpretation is broad and that the guidance provided in the final interpretation might affect the current accounting for a lot of levies. We observe that both the Interpretations Committee and the IASB noted that any taxes that are not within the scope of IAS 12 (or other IFRSs) are within the scope of IAS 37. We also observe that the guidance provided in the final interpretation would not change the current requirements of IAS 37 and would be consistent with the consensus in IFRIC 6 regarding the accounting for WE&EE liabilities. Furthermore, most of the respondents agree that the interpretation is consistent with the requirements in IAS 37 (although some respondents think that it does not provide a fair representation of the economic effects of annual recurring levies when the liability and the corresponding expense are recognised at a point in time).

72. Lastly, we think that the Interpretations Committee is already aware of the likely effects of the interpretation on the accounting for levies. Consequently, we do not think that there is a need to conduct further impact analysis.

Questions for the Interpretations Committee
11. Does the Interpretations Committee agree that it has sufficient information to understand the likely effects of the interpretation on the accounting for levies and agree that further impact analysis is not needed?

The final interpretation should not require additional disclosures specific to levies

73. Some respondents ask for additional disclosures, in particular in interim financial statements. We do not think that there should be additional disclosures specific to levies. IAS 37 already requires disclosing information for each class of provision (subject to materiality). IAS 34 (paragraphs 16A (b), (c) and (h)) also requires disclosing:

    (a) explanatory comments about the seasonality or cyclicality of interim operations;

    (b) the nature and amount of items affecting liabilities that are unusual because of their nature, size or incidence; and

    (c) events after the interim period that have not been reflected in the financial statements for the interim period.

Questions for the Interpretations Committee
12. Does the Interpretations Committee agree that the final interpretation should not require additional disclosures specific to levies?

The Interpretations Committee should not introduce specific requirements regarding levies in IAS 34

74. The Interpretations Committee discussed in the January 2012 Committee meeting whether IAS 34 and the interim accounting should be changed in order to reflect what some might argue is a fairer representation of the economic effects of the levies. In particular, the Interpretations Committee discussed whether a levy cost that is associated with an activity performed in more than one interim period should be allocated to the other interim periods through the use of accruals or deferrals.

75. The Interpretations Committee noted that in Topic 270-10 *Interim Reporting-Overall* in the *FASB Accounting Standards Codification*®, annual operating costs that benefit more than one interim period, or that are

associated with an activity performed in more than one interim period, may be allocated to the other interim periods through the use of accruals or deferrals. For example, property taxes may be deferred and allocated within a fiscal year if the costs benefit more than one interim period. Consequently, US GAAP appears to be different from IFRS for interim reporting.

76. The Interpretations Committee noted that any change to IAS 34 might affect the accounting for other annual recurring operating expenses that are irregularly incurred during the financial year and concluded that there should not be specific requirements introduced in IAS 34 applicable only to levies.

Questions for the Interpretations Committee
13. Does the Interpretations Committee agree that specific requirements regarding levies should not be introduced into IAS 34?

The Interpretations Committee should ask the IASB to consider the issues regarding the accounting for levies when developing the definition and the recognition criteria for a liability in its project on the Conceptual Framework

We note that the IASB decided to restart the project on the Conceptual Framework and agreed that the project should focus on elements of financial statements (including recognition and derecognition). As a result, we think that the Interpretations Committee should ask the IASB to consider the issues regarding the accounting for levies when developing the definition and the recognition criteria for a liability in its project. In particular, we think that the IASB should test how the definition and recognition criteria of a liability would apply to the accounting for levies.

Questions for the Interpretations Committee
14. Does the Interpretations Committee agree with our recommendation to ask the IASB to consider the issues regarding the accounting for levies when developing the definition and recognition criteria of a liability in its project on the Conceptual Framework?