STAFF PAPER

September 2014

IFRS Interpretations Committee Meeting

Project	IFRIC 21 *Levies*		
Paper topic	Levies raised on production property, plant, and equipment		
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Purpose of this paper

1. IFRIC 21 *Levies* is an Interpretation of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The IFRS Interpretations Committee (the Interpretations Committee) has received two submissions relating to levies raised on production property, plant and equipment (PPE). The submitters request clarification on how to account for the costs arising from this type of levy.

2. Neither IFRIC 21 nor IAS 37 provide guidance on whether the costs arising from recognising a levy, or a liability, give rise to an asset or an expense. Both the Standard and the Interpretation advise the reader to apply other Standards to answer this question. Consequently, in addressing the questions raised in these submissions, we will not refer to IFRIC 21, but to other Standards. This is not an IFRIC 21 issue as such, but, because it relates to a 'levy' we have entitled the project 'IFRIC 21' for convenience.

3. The submitters ask whether a particular levy is:

   (a) an administrative cost to be recognised as an expense as it is incurred (View A in both submissions); or

   (b) a fixed production overhead to be recognised as part of the cost of the entity's inventory in accordance with IAS 2 *Inventories* (View B in both submissions).

4. They also ask whether the 'matching' guidance in IAS 18 *Revenue* should be applied.

Examples submitted

5. Both submitters are subject to the same levy and both have similarities in their business models.

6. An entity pays an annual levy that is linked to the existence of PPE at a given date, typically 1 January. The levy is payable on 1 April. The levy is assessed on the value of the production asset or on its technical characteristics. The business of both submitters is that of a service provider that is capital-intensive; a significant part of its costs of sales are depreciation of PPE. Because the service is supplied continuously to the customer, the service provider has no inventories. Revenue is recognised as the service is delivered; production costs and overheads are apportioned to each period of service. The levy is raised in France.

7. The submitters think that when IFRIC 21 is applied, the levy on production assets could either be recognised as part of the cost of inventories (ie as a fixed production overhead) or as an expense (ie as an administrative overhead).

Paper structure

8. The paper is organised as follows:

   (a) outreach conducted;

   (b) accounting for the costs that arise from recognising a liability to pay the levy;

   (c) the IASB's project on the *Conceptual Framework*;

   (d) assessment against our agenda criteria; and

   (e) summary and staff recommendation.

9. A draft agenda decision is included as Appendix A to the paper. For convenience, extracts from Agenda Papers of the *Conceptual Framework* project, relating to the definition of liabilities and its potential interaction with IFRIC 21, are included as Appendix B to this paper. The two submissions received are attached as Appendix C. Both submitters, Orange S.A. and EDF S.A., have waived their right to anonymity.

Outreach conducted

10. IFRIC 21 is effective from January 2014 although it will not be mandatory in the European Union (the EU) until January 2015. Consequently, reporting in accordance with the Interpretation is still at an early stage.

11. We contacted two regulatory bodies, members of the International Forum of Accounting Standard-Setters (IFASS) and a number of accounting firms. Outreach participants were asked to indicate:

    (a) whether they have come across a levy on production assets and, if so, whether that was restricted to France or whether it is applied in other jurisdictions?

    (b) what the predominant practice is in their jurisdiction(s)?

12. Because IFRIC 21 is at an early stage of implementation, we also asked outreach participants which accounting treatment (immediate recognition as an expense or recognition as an asset) they think best depicts accounting for the costs associated with of this type of levy-based transaction?

13. They were also asked to provide any examples that they had of current practice as applied to accounting for levies raised on production assets.

Analysis of respondents

14. We received twenty responses to our outreach request:

Nature of respondent	**Number**
Standard-setters	14
Accounting firms	5
Regulator bodies	1
Total	**20**

Geographical location of respondent	**Number**
Africa	1
Asia and Oceania	6
Europe	4
Global	6
Latin America	1
North America	2
Total	**20**

Occurrence of levies on production assets

15. We understand that the levy on production assets in France is applied to:

    (a) networks used to provide telecommunication services;

    (b) rolling stock for rail transportation;

    (c) gas distribution networks; and

    (d) some types of electricity-producing plants.

16. No one reported any other examples of a levy imposed on a production asset in their jurisdiction. A non-European respondent suggested that these levies arise in Belgium as well as in France. Several respondents noted that, although this specific type of levy did not apply in their jurisdiction, property taxes and land levies are similar in substance if the property or land subject to the levy is part of an entity's production site or factory.

Predominant practice with respect to levies on production assets

17. Most respondents thought that it was too soon after the effective date to know how the Interpretation would be applied. We also note that the Interpretation is not yet mandatory in the EU.

18. A non-European respondent thought that these levies are currently recognised as prepaid expenses and are amortised to production overheads in both France and Belgium. One submitter currently apportions a part of the annual levy to each period in which the service is delivered.

Respondents' preferred accounting treatment

19. A number of respondents noted that IFRIC 21 does not address how the costs should be accounted for. One went on to say that, consequently, the costs should be accounted for in accordance with whatever Standard applied to the costs prior to the application of IFRIC 21. In their view, the application of IFRIC 21 should not affect the accounting approach used for the costs. A number of respondents note that the accounting method applied will depend on the relevant facts and circumstance and the detailed guidance in other Standards. Several respondents did not state a preference.

20. Specific comments received on each potential accounting approach, with reference to specific Standards, are discussed in more detail in the next section of the paper. Not all respondents commented on all potential accounting approaches.

Accounting for the costs that arise from recognising a liability to pay the levy

Interpretation Committee discussions

21. When developing IFRIC 21, the Interpretations Committee discussed recognition of the costs at four meetings. In these discussions they considered;

    (a) whether the payment of the levy generates a future economic benefit, ie whether the costs should be recognised as an asset;

    (b) whether the costs should be recognised as a prepaid expense;

(c) whether the costs should be recognised as an intangible asset;

(d) whether a levy represents an exchange transaction; and

(e) whether recurring, annual levies should be treated on an annual basis.

22. The Interpretation Committee's original proposal in the Exposure Draft was that the costs should be recognised as an expense, unless the levy is an exchange transaction in which the entity receives assets or future services in consideration for the payment of the levy.

23. The Interpretations Committee considered the staff's analysis of the 53 comment letters received on the draft proposals at its November 2012 meeting. Several respondents thought that the costs should not be recognised as an expense, but should be recognised as an asset:

(a) Some respondents thought that the determination of whether a levy is a non-exchange transaction is highly subjective.

(b) Some thought that the entity paying a levy does receive a service, even if the service is not identifiable or is not received directly in exchange for payment of the levy. They think that in these circumstances the cost represents a prepaid expense.

(c) Others think that the levy is similar to a licence to operate and is an intangible asset.

(d) Other respondents thought that some levies constitute a cost attributable to acquiring an asset and could be capitalised in accordance with IAS 2, IAS 16 or IAS 38, depending on the nature of the levy.

24. Other respondents noted that IAS 37 does not address accounting for the costs nor does it address the pattern of expense recognition. Consequently, they thought that the Interpretation should only address the recognition of the liability.

25. The Interpretations Committee did not identify an underlying principle that could be applied to the recognition of the debit side of the entry. It also noted that IAS 37 does not specify whether expenditures are treated as assets or as expenses. Consequently, the Interpretations Committee decided that the Interpretation should not address accounting for the costs. Paragraph 3 of the Interpretation states:

> This Interpretation does not address the accounting for 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.

Possible alternative accounting treatments

26. The submitters asked whether the costs should be recognised as an expense or as the inventory of a service provider. They also considered whether the costs could be treated as a prepaid expense. In investigating this submission and conducting outreach, three further alternative accounting treatments were also identified.

27. For completeness, six possible alternative accounting treatments are considered in this paper for recognising the costs arising from the recognition of a levy based on production assets. These costs could potentially be recognised as:

    (a) an expense;

    (b) part of the cost of the inventory of a service provider in accordance with IAS 2;

    (c) a prepaid expense;

    (d) part of the purchase price of the PPE in accordance with IAS 16;

    (e) part of the cost of PPE as a cost directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended, in accordance with IAS 16; or

    (f) part of the cost of an intangible asset in accordance with IAS 38.

28. These are each discussed separately below.

Immediate recognition as an expense

29. The submitters ask, in each of their Views A, whether the costs should be recognised as an expense. The Interpretations Committee's original proposal had been to recognise costs as an expense but following comments received on the ED, the Interpretations Committee decided to exclude accounting for the costs from the scope of the Interpretation.

Outreach response

30. Two respondents to our outreach on this submission think that, in the example of a levy on a production asset, the costs should be recognised as an expense on initial recognition because no future economic benefit arises from paying the levy and, consequently, the costs would not meet the definition of an asset.

31. A number of respondents think that the cost would be recognised as an expense because they think that the costs did not qualify for recognition as part of an asset recognised in accordance with any of the Standards suggested.

Recognition as inventory

32. The submitters , in each of their Views B, ask whether the costs could be recognised as the inventory of a service provider. In this discussion three aspects of accounting for inventory are considered:

(a) whether the levy represents an administration or production overhead;

(b) whether the levy needs to be linked with units of production; and

(c) whether a service provider can recognise costs as inventory if it has no physical inventory.

Administration or production overhead

33. Supporters of View A think that the levy on production assets is an administration overhead because it does not contribute to bringing inventories to its present location and condition. Supporters of View B think it qualifies as a production overhead because the levy's link to production assets means that the cost is directly attributable to production.

Link with units of production

34. Paragraph 19 of IAS 2 states that service providers' inventories are measured at the cost of production. Some argue, therefore, that the levy cannot be a production overhead because the levy is based on ownership at a specific date, independent of the level of production.

35. The submitters, however, analogise this cost to other, fixed costs, that cannot be attributed to individual units of production such as depreciation or factory administration. Paragraph 12 of the Standard states that:

> … Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration. …

36. Consequently, supporters of View B think that the costs attributable to the levy meet the conditions of a production overhead and could be recognised as part of the cost of inventory in accordance with IAS 2.

Absence of physical inventories

37. Paragraph 19 of the Standard begins 'To the extent that the service provider has inventories …'. Some think that this prohibits service providers without physical inventory from recognising any costs as inventory.

38. Supporters of View B do not think that the wording of paragraph 19 precludes a service provider from recognising these costs as inventory. They think that this wording is only

a reminder that service providers do not routinely account for inventories. They refer to paragraph 8 of the Standard:

> In the case of a service provider, inventories include the costs of the service, as described in paragraph 19, for which the entity has not yet recognised the related revenue.

39. The staff also notes paragraph 29 of IAS 2, which deals with net realisable value:

> … Service providers generally accumulate costs in respect of each service for which a separate selling price is charged. Therefore, each service is treated as a separate item.

40. The staff thinks that this guidance indicates that IAS 2 does not preclude the recognition of costs as inventory by the absence of physical inventory.

41. Supporters of View B think that the costs that arise from recognising a liability to pay a levy on a production asset represent a fixed production overhead and should be included in the cost of inventories. They think that these costs would then be recognised as an expense in the period in which the related revenue is recognised.

Outreach response

42. One respondent thinks that these costs should be recognised as part of the costs of inventories. Another respondent to our outreach provided further discussion in support of recognising the costs as a production overhead in accordance with IAS 2. This respondent thinks that the distinction between a production overhead and an administration overhead is dependent on the nature of the cost, not the timing of recognition of the liability.

43. Three other respondents, however, thought that IAS 2 could not be applied to this transaction because the service providers do not have physical inventory. They think that the wording of paragraph 19 of the Standard *does* preclude the service provider from recognising inventory. One of these respondents noted that in its jurisdiction levies on property were included as part of the costs of inventory only if the entity already accounted for inventory. A fourth respondent thought it would be difficult to include the levy in inventory when no inventory existed at the end of the reporting period, but that this assessment should be made in accordance with the Standard.

44. Another respondent did not think that the costs arising from the levy met the definition of inventories, because they were neither goods held for resale, used in the production of goods held for resale or consumed in rendering services.

Recognition as a prepaid expense

45. The submitters also draw attention to the 'matching' requirement of IAS 18 *Revenue*. They refer to paragraph 19 of that Standard:

> Revenue and expenses that relate to the same transaction or other event are recognised simultaneously; this process is commonly referred to as the matching of revenues and expenses.

46. The submitters ask whether the costs associated with recognising the levy could be recognised as a prepaid expense. In support of View B, some think that the levy expense could be matched with the associated service revenue when the service is provided, ie throughout the period, in accordance with the requirements of paragraph 19 of IAS 18.

Outreach response

47. One respondent thinks that current practice in France and Belgium is to recognise these costs as prepaid expenses. Another respondent analogises the levy with a property tax in their jurisdiction that is recognised as a prepayment and amortised over time. However, a third respondent does not support the recognition of a prepaid expense on the basis of matching. Instead, they think that the applicability of this approach, ie recognition of a prepaid expense, would depend on the relevant legislation and might be appropriate if, for example, the levy is refundable in some circumstances.

48. A further respondent thinks that because the levy cost is incurred regardless of revenue, the expense cannot be matched with the associated service revenue. A second respondent also struggles with this 'matching' view because they do not see the expense as one that is incurred to provide the service to the customer.

49. A third respondent thinks that the Interpretations Committee was clear that a levy is not a prepaid expense. They base this view on paragraph 14 of the Interpretation:

> An entity shall recognise an asset if it has prepaid a levy but does not yet have a present obligation to pay that levy.

50. In the staff view, this paragraph makes it clear that, in the circumstances specified, the debit gives rise to a prepaid levy. We don't think, however, that providing this specific example precludes other examples from also giving rise to a prepayment. It would depend on the individual facts and circumstances.

51. The need to link the cost directly with the provision of the service to the customer echoes the requirements of IFRS 15 *Revenue from Contracts with Customers*. Although this Standard is not applied at present by either submitter, it provides some information about the IASB's most recent thinking on this topic:

> 95 If the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard…, an entity shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all three of the following criteria:

> (a) the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify ... ;
>
> (b) the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and
>
> (c) the costs are expected to be recovered.

52. One respondent thinks that if the levy were linked to the use of the PPE over time, rather than to its ownership or existence at a point in time, it would be appropriate to recognise it as a prepaid expense and amortise it over the period of use.

Recognition as PPE

53. One view that arose in our discussions is that the levy could be recognised as part of the purchase price of PPE on the basis of paragraph 16(a) of IAS 16.

> The costs of an item of property, plant and equipment comprises:
>
> (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;

54. This treatment would analogise the levy to irrecoverable import duty or purchase taxes. Opponents of this view, however, note that the cost is not linked with the purchase of the asset, but is incurred at a subsequent date as a result of the service provider's continued ownership of the production asset.

55. Alternatively, some suggest that the levy could be recognised as PPE in accordance with paragraph 16(b) of IAS 16 as 'a cost directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management'.

56. Opponents of this view think that the cost of the levy does not affect either the location or condition of the production asset nor does it enhance the asset. They also refer to paragraph 20 of IAS 16, which requires cost recognition to cease once the asset is in the required location and condition. Consequently, they think that this approach would not apply to the levy on production assets.

Outreach response

57. One respondent thought that initial recognition of the levy as a cost required to bring the asset to the location and condition necessary for it to be capable of operating in the manner intended was sound. They went on to say that the payment of the levy each year might also be capitalised as PPE as an enhancement of the asset by analogy with paragraph 14 of IAS 16. That paragraph refers to capitalising the costs associated with a specific condition of continuing to operate an aircraft, its annual safety inspection.

58. However, seven respondents to our informal outreach did not think that the costs could be recognised as PPE in accordance with IAS 16.

59. Two of these respondents also noted that, if recognised in accordance with IAS 16, the annual levy cost would represent a component of cost that would be replaced annually and depreciated over a shorter period than the full asset.

Recognised as an intangible asset

60. Two respondents asked whether the costs could be recognised as an intangible asset in accordance with IAS 38. They analogise the payment of the levy to a licence to operate in the service provider's market.

61. Whether the costs represent an intangible asset was discussed by the Interpretations Committee at its November 2011 meeting in Agenda Paper 2B *Debit side of the liability*. The paper can be accessed by following this link: http://www.ifrs.org/Meetings/Pages/Interpretations-Committee-Nov-11.aspx.

62. As a result of these discussions the Interpretations Committee tentatively decided that the costs should be recognised as an expense unless the levy is an exchange transaction in which the entity receives assets or future services in consideration for the payment of the levy. The paper suggested the following indicators that the payment of the levy is an exchange transaction:

    (a) The calculation of the levy is based on data that measures the entity's activity in the market such as revenue or market share.

    (b) The entity is granted distinct legal rights that prevent other entities from entering the market.

    (c) The market is highly profitable and very few entities are able to operate in the market.

63. The staff think that more information would be required to decide whether this levy meets the definition and recognition requirements of an intangible asset in accordance with IAS 38.

Staff summary

64. The staff agrees with those respondents who note that paragraph 3 of IFRIC 21 states that the Interpretation does not address the accounting for costs that arise from recognising a liability to pay the levy. Consequently, the staff thinks that the application of IFRIC 21 should not affect the accounting approach used for the costs.

65. The staff also agrees with those respondents who think that the accounting method applied will depend on a detailed analysis of the relevant facts and circumstance and a comparison of that analysis with the detailed guidance in other Standards.

66. The staff notes several points of similarity as presented by the submitters between the levy and the fixed production overheads in paragraph 12 of IAS 2. Furthermore, they note wording in that Standard, applicable to the costs of service providers, that were not attributable to items of physical inventory. Consequently, the staff thinks that inventories recognised by service providers need not relate to physical inventories.

67. However, the staff note the varied views on accounting for these costs, depending on specific facts and circumstances, that were received during outreach and, in a more general way, during consultation on the Interpretations Committee's original proposals.

Staff recommendation

68. Assessing whether these costs should be recognised as an expense or as part of the cost of an asset recognised in accordance with another Standard is a complex process based on a detailed understanding of the entity's individual facts and circumstances and the terms of the enabling legislation that imposed the levy. The staff do not have this information; nor do they think it would be appropriate for the Interpretations Committee to undertake this analysis.

   (a) It is not our practice to give case-by-case advice on individual fact-patterns.

   (b) A number of possible accounting approaches to accounting for the costs were identified and the outreach that we conducted indicated a range of views about which of these different approaches should apply to this transaction. Significant amounts of judgement would need to be applied in making this determination.

   (c) Despite discussing a number of examples during the development of the Interpretation, the Interpretations Committee did not identify a general principle for accounting for the costs side of a levy-based transaction. Consequently, the Interpretations Committee excluded accounting for the debit side of a levy transaction from the Interpretation. The staff does not think that it is likely that any further analysis they might now do on this example would identify an underlying principle of cost recognition for levies.

   (d) Although a detailed analysis of the fact pattern is required in order for the accounting treatment to be agreed, the staff does not think that IAS 2, IAS 16, IAS 18 or IFRIC 21 are unclear or inconsistent with each other or with the *Conceptual Framework*. Consequently, they do not think that, even if consensus were reached in this particular example, the analysis would result in a proposed amendment to IFRS that would clarify the accounting for a broader range of examples.

The IASB's project on the *Conceptual Framework*

69. The *Conceptual Framework* project team is currently considering concepts to explain the meaning of the term 'present obligation' with respect to the definition of a liability. The IASB has tentatively decided to propose concepts that, if applied to levies within the scope of IFRIC 21, would lead to some levies being recognised sooner than they are currently recognised when applying IFRIC 21. These discussions are summarised, for convenience, in Appendix B to this paper.

70. If the IASB finalises these proposals and decides to take on a project to amend IAS 37, it might at the same time change the requirements of IFRIC 21. However, these changes would affect only the timing of the recognition of liabilities for some levies. They would be unlikely to affect any requirements relating to the accounting for associated costs. Accordingly, in the staff view, the outcome of the *Conceptual Framework* project will have little bearing on the question under consideration in this paper.

Assessment against our agenda criteria

71. We have assessed this issue against the agenda criteria of the current *Due Process Handbook*:

Paragraph 5.16 states that we should address issues:	Agenda criteria satisfied?
that have widespread effect and have, or are expected to have, a material effect on those affected;	**Yes** Although we think these specific types of levies only apply in France and Belgium, levies on production assets are also imposed through more general property or land levies, which are raised in a number of jurisdictions. The accounting treatment used for these transactions could have a material effect on those affected.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and	**Yes** Information about emerging practice following the application of IFRIC 21 is not yet available. However, given the range of views received through outreach we are concerned that diversity in practice could arise.
that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*.	**Yes** Although we think that resolving this issue requires applying significant judgement to an assessment of the facts and circumstances of the specific levy against a range of Standards, such as IAS 2, IAS 18 and IAS 38.
In addition:	
Can the Interpretations Committee address this issue in an efficient manner (paragraph 5.17)?	**No** The Interpretations Committee identified the complexity involved in determining how the debit would be treated when developing the Interpretation and, being unable to identify an underlying principle for recognition of the debit, excluded accounting for these costs from the Interpretation.
The solution developed should be effective for a reasonable time period. (paragraph 5.21)	**Yes** In the staff's view, any future changes to IAS 37 would be unlikely to have a bearing on the question asked in these submissions.

72. Although this issue satisfies a number of the agenda criteria of the IASB's *Due Process Handbook*, we do not think that this topic should be added to the Interpretations Committee's agenda because it is unlikely that the Interpretations Committee will be able to identify a general principal that would apply to the costs of all levies.

Summary and staff recommendation

73. The staff thinks that this topic should not be added to the Interpretations Committee's agenda.

    (a) The staff notes that it is not our practice to give case-by-case advice on individual fact patterns.

    (b) The staff thinks it is unlikely that addressing an individual type of levy will identify a more general principle that could be applied to the cost associated with different types of levies. IFRIC 21 points to other Standards to resolve whether costs are recognised as an expense or part of the cost of an asset recognised in accordance with another Standard.

    (c) The staff also thinks that it is unlikely that the Interpretation Committee could achieve consensus on the outcome of any assessment with respect to these costs in an efficient manner.

74. The staff includes a draft tentative agenda decision, prepared in accordance with this recommendation, as Appendix A to this paper.

Questions for the Interpretations Committee
1, Do you agree with the staff recommendation not to add this topic to the Interpretation Committee's agenda? 2. Do you agree with the wording of the draft tentative agenda decision in Appendix A?

Appendix A Draft tentative agenda decision

IFRIC 21 *Levies*—Levies raised on production PPE

The Interpretations Committee has received two submissions relating to levies raised on production property, plant and equipment (PPE).

IFRIC 21 *Levies* does not provide guidance on accounting for the costs arising from recognising a levy. The Interpretation notes that entities should apply other Standards to decide whether the recognition of an obligation for a levy gives rise to an asset or an expense. The submitters, both service providers, ask whether the cost of a levy on productive assets is:

(a) an administrative cost to be recognised as an expense as it is incurred; or

(b) a fixed production overhead to be recognised as part of the cost of the entity's inventory in accordance with IAS 2 *Inventories*.

The Interpretations Committee discussed whether the costs of the levy should be recognised as an expense ,a prepaid expense or as part of the cost of an asset in accordance with IAS 2, IAS 16 *Property Plant and Equipment* or IAS 38 *Intangible Assets*.

The Interpretations Committee noted that it had discussed the accounting for costs that arise from recognising the liability for a levy when the Interpretation was developed. At that time it considered whether such costs would be recognised as an expense, a prepaid expense or as an asset recognised in accordance with IAS 2, IAS 16 *Property Plant and Equipment* or IAS 38 *Intangible Assets*. The Interpretations Committee decided not to provide guidance on this matter at that time because it could not identify a general principle for accounting for the costs side of a levy-based transaction ,

In the light of this, the Interpretations Committee concluded that it would be unlikely that it could reach consensus on how the costs should be recognised in this particular case. It also noted that it would not be efficient to give case-by-case guidance on individual fact patterns.

Consequently, the Interpretations Committee [decided] not to add this issue to its agenda.

The Interpretations Committee also discussed whether service providers could recognise production overheads as inventory in accordance with IAS 2 in the absence of physical inventory. The Interpretations Committee agreed with the staff view that inventory recognised by service providers need not relate to physical inventories.

Appendix B Extracts from the IASB's project on the *Conceptual Framework*

Meaning of present obligation

1. Paragraphs 3.63-3.97 of the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* considered three views on the meaning of 'present obligation'. A present obligation must have arisen from a past event and be:

   (a) *View 1*: strictly unconditional;

   (b) *View 2*: practically unconditional; or

   (c) *View 3*: may be conditional on the entity's future actions.

2. View 1 is consistent with IFRIC 21—a present obligation to pay the levy arises only when there is an unconditional obligation. However, the IASB has subsequently tentatively rejected a definition of 'present obligation' based on this view.

3. Agenda Paper 10D for the IASB's March 2014 meeting discussed the comment letter analysis received on these proposals. Paragraph 16 of that paper notes that virtually all respondents agreed with rejection of View 1.

4. Paragraph 19 of that paper also refers to respondents' questions about the interaction of the IASB's proposals in the Discussion Paper with IFRIC 21:

   > Some respondents asked the IASB to consider the consequences of rejecting View 1, especially for IFRIC 21 *Levies*, which applies a similar view and is coming into effect this year.

Interaction of the project with IFRIC 21

5. As part of the redeliberations of the comments received on the Discussion Paper, the staff considered the effect of any changes to the concepts on existing Standards. This topic was considered in Agenda Paper 10C, discussed at the IASB's July 2014 meeting:

   > 50 If the *Conceptual Framework* defined an obligation as one that the entity has no practical ability to avoid (View 2) the main inconsistency would be between the *Conceptual Framework* and IFRIC 21 *Levies*. The inconsistency would affect in particular levies that accumulate over time but are payable only if a further condition is met, for example if the entity is still operating in the market on a later date. Applying IFRIC 21, liabilities are identified only when all conditions are met. Applying View 2, liabilities would be identified as accruing over time, unless the entity could avoid the remaining conditions (eg leave the market)

without significant business disruption, and without economic consequences significantly more adverse than paying the levy. We think it is likely that, in practice, many levy liabilities would be identified as accruing over time.

51 If the *Conceptual Framework* defined an obligation as one that the entity has less than complete discretion to avoid (View 3), there would again be inconsistencies between the *Conceptual Framework* and IFRIC 21. Applying View 3, levies that accumulate over time would be identified as accruing over time, irrespective of remaining conditions.

6. At its meeting in July 2014, the IASB tentatively decided that an entity has a present obligation to transfer an economic resource as a result of past events if the entity has both no practical ability to avoid the transfer and the amount of the transfer is determined by reference to benefits received, or activities that it has conducted, in the past. This tentative decision reinforces the IASB's tentative decision to reject View 1, 'unconditional obligation', proposed in the Discussion Paper.

7. As part of its research programme, the IASB will be considering whether to add to its active agenda projects to amend aspects of IAS 37. If the IASB finalises its *Conceptual Framework* proposals on the meaning of the term 'present obligation', those projects could include a project to align the requirements of IAS 37 and IFRIC 21 with the revised definition of a liability. Consequently, it is possible that the requirements of IFRIC 21 will change in the medium term.