CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

FEBRUARY 2014

CPA Canada Financial Reporting Alert

IFRS

IFRIC 21 *Levies*

In May 2013, the International Accounting Standards Board (IASB) published a new Interpretation IFRIC 21 *Levies*, which provides guidance on when to recognize a liability for a levy imposed by a government, both for levies that are accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and those where the timing and amount of the levy is certain.

This *CPA Canada Financial Reporting Alert* highlights the basic requirements of IFRIC 21, considers possible business implications, and suggests an action plan to implement the interpretation.

Why does IFRIC 21 matter to me?

Entities which pay levies imposed by governments (including government agencies and similar bodies whether local, national or international), other than income taxes, may be significantly affected by IFRIC 21.

IFRIC 21 could result in different recognition of a liability compared to current practice, particularly in connection with levies that are triggered by circumstances on a specific date.

A careful review of all payments made to governments is required.

When is IFRIC 21 effective?

- IFRIC 21 is effective for annual periods beginning on or after January 1, 2014.
- Entities preparing interim financial statements will be required to apply IFRIC 21 to their interim reports. For example, a public company with a December 31, 2013 year end will need to apply IFRIC 21 to its interim report for the quarter ended March 31, 2014.

What are the transitional requirements?

- Changes in accounting policies resulting from the initial application of IFRIC 21 should be accounted for retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

What are the basics of IFRIC 21?

What is a levy?

A levy is defined as an outflow of resources (embodying economic benefits) that is imposed by governments (including government agencies and similar bodies whether local, national or international) on entities in accordance with legislation (i.e., laws and/or regulations).[1]

What types of payments are included and excluded within the scope IFRIC 21?

Included (in scope)	**Excluded (out of scope)**
• IFRIC 21 addresses the accounting for a liability to pay a levy if that liability is within the scope of IAS 37. It also addresses the accounting for a liability to pay a levy whose timing and amount is certain.	IFRIC 21 does not apply to government payments that: • Do not meet the definition of a levy; • Are within the scope of other Standards (such as income taxes that are within the scope of IAS 12 *Income Taxes*); • Are made by an entity for the acquisition of an asset from a government; • Are for the rendering of services under a contractual agreement with a government; • Are imposed for breaches of legislation (e.g., fines or other penalties); • Arise from emission trading schemes.

When do I record a liability to pay a levy?

- 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.
- The activity that triggers payment may occur "over time" (e.g., revenue generating activities occurring during a year) or be at a "point-in-time" (e.g., a specified date or when a transaction occurs). In particular:
  - The recognition of a levy liability occurs progressively so long as the obligating event itself occurs over a period of time.
  - If the levy is subject to a minimum threshold, recognition of a liability to pay the levy occurs only at the point the minimum threshold is reached, and not before.
- A liability to pay a levy is not recognized at an earlier date, even if the entity has no realistic opportunity to avoid paying the levy.[2]
- The timing of liability recognition will depend on the precise wording of the relevant legislation.
- Refer to Appendix 1 for illustrative examples.

Would the cost of the levy be recorded as an asset or expense?

- IFRIC 21 only provides guidance about when to recognize a liability.
- Other IFRSs should be applied to determine if the cost (i.e., the debit side of the entry) is an asset or an expense.

Do the same accounting principles apply in both annual and interim financial statements?

Yes, the same recognition principles must be applied in the annual and interim financial statements, even if such recognition results in "uneven" recognition over the course of the year.

What resources are available to help me?

IFRS Discussion Group

The Accounting Standards Board (AcSB) established the IFRS Discussion Group to implement and maintain a regular public forum to discuss issues that arise in Canada when applying International Financial Reporting Standards (IFRSs).

The IFRS Discussion Group recently discussed IFRIC 21, considering the potential implications of the interpretation.

Audio webcasts of the IFRS Discussion Group's discussion are available online at www.frascanada.ca.

Accounting Standards Board (AcSB)

IFRIC 21 was discussed at the January 2014 AcSB meeting. A decision summary highlighting key discussion items is available on www.frascanada.ca.

CPA Canada

CPA Canada is committed to providing guidance and support for understanding and applying IFRSs.

CPA Canada has compiled various IFRS technical summaries, practical application guides and frequently asked question documents aimed at supporting the understanding and application of IFRSs.

To access our online library of IFRS resources, visit the IFRS "Applying a New Standard" section of our website.

What’s my action plan?

	Action	Milestones (What)	Timeline (When)	Resources (Who)
1	**Understand**	Understand IFRIC 21: • Read IFRIC 21. • Download and review IFRIC 21 related information from the IASB website. • Consider other externally prepared information on this topic (e.g., refer to the CPA Canada website for a variety of externally prepared summary documents). • Discuss the implications of IFRIC 21 with industry peers or a trusted business advisor. • Consider education and training available on this topic.	*[Set specific due date for achieving milestones]*	*[Determine who will implement the milestones and what resources are required]*
2	**Review**	Review processes (including systems, data collection and internal controls): • Identify required but unavailable information and develop a plan for obtaining such data. — Compile an inventory listing of all government payments. — Review the terms and conditions associated with each government payment. — Identify government payments that meet the definition of a levy. • Consider new information needs and compare needs to current system/process capabilities. • Assess the adequacy of existing controls and procedures and consider the necessary new controls to support any revised processes.		
3	**Assess**	Assess the effect of IFRIC 21: • Compare the accounting guidance in IFRIC 21 to your entity’s current accounting policy. • Consider the required changes to your entity’s current accounting policy. • Discuss any potential changes with the entity’s auditor. • Adopt and communicate required changes to appropriate personnel. • Assess the implications for contractual arrangements—consider modifying agreements if necessary. • Consider tax implications (if any). • Consider the effect on key financial ratios, performance metrics and covenants.		
4	**Implement**	Implement IFRIC 21: • Update the entity’s accounting policy to reflect IFRIC 21 guidance. • Apply IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. — Changes in accounting policies resulting from the initial application of IFRIC 21 should be accounted for retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.		
5	**Communicate**	Communicate the effects of IFRIC 21: • If appropriate, communicate with Board of Directors and the Audit Committee. • If applicable, develop a communication plan to inform all stakeholders (e.g., lenders, investors) of the associated changes made to your entity’s accounting policy as a result of implementing IFRIC 21.		

Appendix 1—Illustrative Examples

The following selected illustrative examples have been reproduced from IFRIC 21. These examples accompany, but are not part of IFRIC 21.

The objective of these examples is to illustrate how an entity should account for a liability to pay a levy in its annual financial statements and in its interim financial report.

Example—A levy is triggered progressively as the entity generates revenue

Entity A has an annual reporting period that ends on December 31. In accordance with legislation, a levy is triggered progressively as an entity generates revenue in 20X1. The amount of the levy is calculated by reference to revenue generated by the entity in 20X1.

In this example, the liability is recognized progressively during 20X1 as Entity A generates revenue, because the obligating event, as identified by the legislation, is the generation of revenue during 20X1. At any point in 20X1, Entity A has a present obligation to pay a levy on revenue generated to date. Entity A has no present obligation to pay a levy that will arise from generating revenue in the future.

In the interim financial report (if any), the liability is recognized progressively as Entity A generates revenue. Entity A has a present obligation to pay the levy on revenue generated from January 1, 20X1 to the end of the interim period.

Example—A levy is triggered in full if the entity operates as a bank at a specified date

Entity C is a bank and has an annual reporting period that ends on December 31. In accordance with legislation, a levy is triggered in full only if an entity operates as a bank at the end of the annual reporting period. The amount of the levy is calculated by reference to the amounts in the statement of financial position of the entity at the end of the annual reporting period. The end of the annual reporting period of Entity C is December 31, 20X1.

In this example, the liability is recognized on December 31, 20X1 because the obligating event, as identified by the legislation, is Entity C operating as a bank at the end of the annual reporting period. Before that point, Entity C has no present obligation to pay a levy, even if it is economically compelled to continue to operate as a bank in the future. In other words, the activity that triggers the payment of the levy, as identified by the legislation, is the entity operating as a bank at the end of the annual reporting period, which does not occur until December 31, 20X1. The conclusion would not change even if the amount of the liability is based on the length of the reporting period, because the obligating event is the entity operating as a bank at the end of the annual reporting period.

In the interim financial report (if any), the liability is recognized in full in the interim period in which December 31, 20X1 falls because the liability is recognized in full on that date.

Example—A levy is triggered if the entity generates revenue above a minimum amount of revenue

Entity D has an annual reporting period that ends on December 31. In accordance with legislation, a levy is triggered if an entity generates revenue above $50 million in 20X1. The amount of the levy is calculated by reference to revenue generated above $50 million, with the levy rate at 0 per cent for the first $50 million revenue generated (below the threshold) and 2 per cent above $50 million revenue. Entity D's revenue reaches the revenue threshold of $50 million on July 17, 20X1.

In this example, the liability is recognized between July 17, 20X1 and December 31, 20X1 as Entity D generates revenue above the threshold because the obligating event, as identified by the legislation, is the activity undertaken after the threshold is reached (i.e., the generation of revenue after the threshold is reached). The amount of the liability is based on the revenue generated to date that exceeds the threshold of $50 million revenue.

In the interim financial report (if any), the liability is recognized between July 17, 20X1 and December 31, 20X1 as Entity D generates revenue above the threshold.

1. The key word is "imposed". Levies do not arise from executory contracts or other contractual arrangements.

2. The following factors do not create or imply the existence of an obligating event: preparation of the financial statements under the going concern principle and/or economic compulsion of the entity.

Comments on this *CPA Canada Financial Reporting Alert*, or suggestions for future *CPA Canada Financial Reporting Alerts* should be sent to:

Alex Fisher, CPA, CA
Principal, Research, Guidance and Support
International Financial Reporting Standards
Chartered Professional Accountants of Canada
277 Wellington St. West
Toronto, Ontario M5V 3H2
email: alexfisher@cpacanada.ca