Comments due by 31 January 2017

ACCOUNTING STANDARDS BOARD

EXPOSURE DRAFT OF A PROPOSED INTERPRETATION OF THE STANDARDS OF GENERALLY RECOGNISED ACCOUNTING PRACTICE

LIABILITIES TO PAY LEVIES

(ED 153)

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Acknowledgement

This Interpretation of the Standards of Generally Recognised Accounting Practice (IGRAP) is drawn primarily from the equivalent Interpretation of the International Financial Reporting Standard on *Levies* (IFRIC 21) issued by the International Financial Reporting Interpretations Committee (IFRIC) of the International Accounting Standards Board (IASB). The IASB has issued a comprehensive body of IFRICs. Extracts of the IFRIC on *Levies* are reproduced in these Interpretations of the Standards of GRAP with the permission of the IASB.

The approved text of IFRSs is that published by the IASB in the English language and copies may be obtained from:

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LIABILITIES TO PAY LEVIES

Introduction

Interpretation of the Standards of Generally Recognised Accounting Practice

The Accounting Standards Board (the Board) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for:

(a) departments (national, provincial and government components);

(b) public entities;

(c) trading entities (as defined in the PFMA);

(d) constitutional institutions;

(e) municipalities, municipal entities or any other entities under the ownership control of a municipality and boards, commissions, companies, corporations and funds; and

(f) Parliament and the provincial legislatures.

The above are collectively referred to as "entities" in Standards of GRAP.

The Board has approved the application of International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board for:

(a) public entities that meet the criteria outlined in Directive 12 on *The Selection of an Appropriate Reporting Framework by Public Entities;* and

(b) entities under the ownership control of any of these entities.

Financial statements should be described as complying with Standards of GRAP only if they comply with all the requirements of each applicable Standard of GRAP and any related Interpretations of the Standards of GRAP.

The Interpretation of the Standards of GRAP on *Liabilities to Pay Levies* is set out in paragraphs .01 to 18. All paragraphs in this Interpretation of the Standards of GRAP on *Levies* have equal authority. The status and authority of appendices are dealt with in the preamble to each appendix. This Interpretation of the Standards of GRAP should be read in the context of its objective, its basis for conclusions if applicable, the *Preface to Standards of*

GRAP, the *Preface to the Interpretations of the Standards of GRAP* and the *Framework for the Preparation and Presentation of Financial Statements*.

Standards of GRAP and Interpretations of the Standards of GRAP should also be read in conjunction with any directives issued by the Board prescribing transitional provisions, as well as any regulations issued by the Minister of Finance regarding the effective dates of the Standards of GRAP, published in the Government Gazette.

Reference may be made to a Standard of GRAP that has not been issued at the time of issue of this Interpretation of the Standards of GRAP. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .11 of the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

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Interpretation of the Standards of GRAP on *Liabilities to Pay Levies*

References

- The Standard of GRAP on *Presentation of Financial Statements* (GRAP 1)
- The Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors* (GRAP 3)
- The Standard of GRAP on *Revenue from Exchange Transactions* (GRAP 9)
- The Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets* (GRAP 19)
- The Standard of GRAP on *Related Party Disclosures* (GRAP 20)
- The Standard of GRAP on *Revenue from Non-exchange Transactions (Taxes and Transfers)* (GRAP 23)
- The Standard of GRAP on *Employee Benefits* (GRAP 25)
- The Standard of GRAP on *Statutory Receivables* (GRAP 108)
- International Accounting Standard on *Income Taxes* (IAS 12)

Background

.01 Government and its entities (hereafter government) generally have broad powers, including the ability to establish and enforce legal requirements, and to change those requirements. Through these powers, government raises resources through taxes and other non-exchange transactions. This includes imposing levies on individuals and entities as required in legislation, supporting regulations or similar means including, but not limited to, laws, regulation, policies, decisions concluded by authorities such as cabinet, executive committees, boards, municipal councils and ministerial orders (hereafter legislation or similar means).

.02 The receipt of these levies by government may result in exchange or non-exchange revenue that is accounted for in accordance with the Standards of GRAP on *Revenue from Exchange Transactions* or *Revenue from Non-exchange Transactions (Taxes and Transfers)*. For the entities paying the levies, this is an obligation and that needs to be recognised in accordance with the Standard of

GRAP on *Provisions, Contingent Liabilities and Contingent Assets.* From a revenue perspective, the timing and recognition of the levies is clear. However, the Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets* is not explicitly clear about the point of recognition for entities paying the levies.

Objective

.03 This Interpretation of the Standards of GRAP provides guidance on the accounting for levies in the financial statements of the entity that is paying the levy. It clarifies when entities need to recognise a liability to pay a levy that is accounted for in accordance with the Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets*.

Scope

.04 This Interpretation of the Standards of GRAP addresses the recognition of a liability to pay a levy if that liability is within the scope of the Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets*. It also addresses the recognition of a liability to pay a levy whose timing and amount is certain. The measurement of a liability to pay a levy is not addressed in this Interpretation of the Standards of GRAP, instead an entity refers to the the Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets*.

.05 This Interpretation of the Standards of GRAP does not address the accounting for the costs that arise from recognising a liability to pay a levy. Entities should apply other Standards of GRAP to decide whether the recognition of a liability to pay a levy gives rise to an asset or an expense.

.06 For the purposes of this Interpretation of the Standards of GRAP, a levy is a non-exchange transaction resulting in an outflow of resources embodying economic benefits or service potential that is imposed by government on entities in accordance with legislation or similar means, other than:

(a) those outflows of resources that are within the scope of other Standards (such as income taxes that are within the scope of the International Accounting Standard on *Income Taxes* or employee-related expenses under the Standard of GRAP on *Employee Benefits* (for example, unemployment insurance fund and workmen's compensation payments);

(b) fines or other penalties that are imposed for breaches of legislation or similar means; and

(c) emissions trading schemes.

'Government' refers to government and its related entities whether local, provincial, national or international.

.07 Items that are considered levies within the scope of this Interpretation of the Standards of GRAP may be referred to as levies or some other term in legislation or similar means, for example, taxes, fees (including licence fees), concessions, tolls, duties, royalties, tariffs, payments, charges, etc. An entity should assess, based on the substance of the transaction rather than the legal form, whether the item is a levy as defined in this Interpretation of the Standards of GRAP.

.08 A payment made by an entity for the acquisition of an asset, or for the provision of goods or services in a binding arrangement with a government in an exchange transaction, does not meet the definition of a levy in this Interpretation of the Standards of GRAP.

.09 In determining whether a payment imposed by government meets the definition of a levy in this Interpretation of the Standards of GRAP, an entity assesses whether the levy is a non-exchange or exchange transaction by considering whether there has been a direct exchange of approximately equal value. This assessment requires judgement, and a detailed consideration of the legislation or similar means as well as the specific facts and circumstances of the levy being paid. Such an assessment is made irrespective of whether an entity makes a payment directly to the government or to a third party acting on behalf of government. For instance, when the levy is payable to a collecting agent, the levy may be a non-exchange transaction even though there has not been a direct exchange between the entity and government.

Issues

.10 To clarify the accounting for a liability to pay a levy, this Interpretation of the Standards of GRAP addresses the following issues:

(a) what is the obligating event that gives rise to the recognition of a liability to pay a levy?

(b) does economic compulsion to continue to operate in a future period create a constructive obligation to pay a levy that will be triggered by operating in that future period?

(c) does the going concern assumption imply that an entity has a present obligation to pay a levy that will be triggered by operating in a future period?

(d) does the recognition of a liability to pay a levy arise at a point in time or does it, in some circumstances, arise progressively over time?

(e) what is the obligating event that gives rise to the recognition of a liability to pay a levy that is triggered if a minimum threshold is reached?

Consensus

.11 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. For example, if a licenced electricity distributor is levied a fee which is payable annually in respect of electricity distributed during the previous calendar year, the activity that triggers the payment of the levy in the current period is the electricity distributed in a previous period. The obligating event is the distribution of electricity in the previous period.

.12 An entity does not have a constructive obligation to pay a levy that will be triggered by operating in a future period as a result of the entity being economically compelled to continue to operate in that future period. For example, an entity may be required to make an annual payment to an industry regulator in order to continue operating in a specific industry. In such cases, the entity does not recognise a liability to pay a levy that will arise from operating in that industry in the future.

.13 The preparation of financial statements under the going concern assumption does not imply that an entity has a present obligation to pay a levy that will be triggered by operating in a future period.

.14 The liability to pay a levy is recognised progressively if the obligating event occurs over a period of time (i.e. if the activity that triggers the payment of the levy, as identified by the legislation, occurs over a period of time).

.15 If an obligation to pay a levy is triggered when a minimum threshold is reached, the accounting for the liability that arises from that obligation shall be consistent with the principles established in paragraphs .11 to.16 of this Interpretation of the Standards of GRAP (in particular, paragraphs .11 and .14). For example, if the obligating event is the reaching of a minimum activity threshold (such as a minimum amount of revenue or sales generated or outputs produced), the corresponding liability is recognised when that minimum activity threshold is reached.

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

Transitional provisions

.17 All changes resulting from the application of this Interpretation of the Standards of GRAP shall be accounted for in accordance with the requirements of the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors*.

Effective date

.18 An entity shall apply this Interpretation of the Standards of GRAP for annual financial statements covering periods beginning on or after DDMMYYYY.

Appendix A - Illustrative examples

This appendix is illustrative only and does not form part of the Interpretation of the Standards of GRAP. The purpose of the appendix is to illustrate the application of the Interpretation of the Standards of GRAP and to assist in clarifying its meaning.

Determining the timing of the recognition for various types of levies

The objective of these examples is to illustrate how an entity accounts for a liability to pay a levy in its annual financial statements. Assume that the levies used in these examples are non-exchange transactions.

Example 1—A levy is triggered progressively

Legislation requires a regulator to impose a levy on distributors of electricity. Entity A is a licenced electricity distributor. In accordance with legislation, the levy is determined based on the electricity distributed during the current period.

The activity that triggers the payment of the levy is the distribution of electricity throughout the current period. The obligating event is the distribution of electricity in the current period. At any point in the current period, Entity A has a present obligation to pay a levy on the electricity distributed to date. Entity A has no present obligation to pay a levy on the electricity to be distributed in the future.

Example 2—A levy is triggered in full

Municipalities have the power to levy property taxes. Property taxes are levied annually and payable at varying times throughout the year. The amount levied depends on the value of the property on the assessment date, and the rate applicable to the nature of the property, such as residential or commercial. Entity B is obligated to pay property tax to a municipality in accordance with legislation or similar means. The property tax is levied at 1% of the assessed value of property on 1 July each year, payable in 12 equal instalments. The entity's reporting period is 1 April 20X1 to 31 March 20X2.

In this example, the liability is recognised in full on 1 July 20X1 as the obligating event is the ownership of property on a specified date (i.e. assessment date). Any payments made by the entity between 1 July 20X1 and 31 March 20X2 will reduce the entity's obligation to the municipality. Any payments made before the obligating event will be recognised as a prepayment.

Variation:

Same fact pattern as above, except that legislation states that if the property is sold during the year, the seller qualifies for a refund of a proportionate share of the property tax paid from the municipality. On 30 September 20X1, Entity B sells the property to another entity.

In this example, Entity B would still recognise the full liability on 1 July 20X1 as the obligating event occurs on that date. However, Entity B is able to obtain a refund of a proportionate share of the property tax paid up to September 20X1.

Example 3—A levy is triggered in full if the entity undertakes specific activities at a specified date

Entity C is a development finance institution and is registered as a financial service provider. In accordance with legislation or similar means, Entity C is required to pay the regulator of financial institutions a levy if that entity operates as a financial service provider at the end of the reporting period. The amount of the levy is calculated by reference to specific amounts in the statement of financial position of the entity at the end of the reporting period. The end of the reporting period of Entity C is 31 March 20X1.

In this example, the liability is recognised on 31 March 20X1 because the obligating event, as identified by the legislation or similar means, is Entity C operating as a financial service provider at the end of the 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 financial service provider in the future. In other words, the activity that triggers the payment of the levy, as identified by the legislation or similar means, is the entity operating as a financial service provider at the end of the reporting period, which does not occur until 31 March 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 financial service provider at the end of the reporting period.

Example 4—A levy is triggered if the entity generates revenue above a minimum amount of revenue

Entity D has a reporting period that ends on 31 March 20X1. In accordance with legislation or similar means, a levy is triggered if an entity generates revenue above R50 million in 20X1. The amount of the levy is calculated by reference to revenue generated above R50 million, with the levy rate at 0 per cent for the first R50 million revenue generated (below the threshold) and 2 per cent above R50 million revenue. Entity D's revenue reaches the revenue threshold of R50 million on 17 January 20X1.

In this example, the liability is recognised between 17 January 20X1 and 31 March 20X1 as Entity D generates revenue above the threshold because the obligating event, as identified by the legislation or similar means, 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 R50 million revenue.

Variation:

Same fact pattern as above (i.e. a levy is triggered if Entity D generates revenue above R50 million in 20X1), except that the amount of the levy is calculated by reference to all revenue generated by Entity D in 20X1 (i.e. including the first R50 million revenue generated in 20X1).

In this example, the liability for the payment of the levy related to the first R50 million revenue, is recognised on 17 January 20X1 when the threshold is met, because the obligating event, as identified by the legislation or similar means, for the payment of that amount is the reaching of the threshold. The liability for the payment of the levy related to revenue generated above the threshold is recognised between 17 January 20X1 and 31 March 20X1 as the entity generates revenue above the threshold, because the obligating event, as identified by the legislation or similar means, is the activity undertaken after the threshold is reached (ie the generation of revenue after the threshold is reached). The amount of the liability is based on the revenue generated to date, including the first R50 million revenue.

Assessing when a levy is within the scope of this Interpretation of the Standards of GRAP

Example 5—Recognition of an asset or expense

This Interpretation of Standards of GRAP does not deal with whether the debit side of the transaction is an asset or expense, except for prepaid levies. Levies are generally not expected to give rise to a stand-alone asset, as payments for the exchange of assets or provision of goods or services are scoped out. The example illustrates a scenario where asset recognition is appropriate under other Standards of GRAP:

An entity imports equipment to be used in the supply of goods and services on which import duties are payable to government in terms of legislation or similar means. Import duty that is payable in terms of legislation or similar means is a levy within the scope of this Interpretation of the Standards of GRAP and is recognised as a liability at the date the goods are imported (i.e. obligating event).

The recognition of import duties as an expense or capitalisation as part of the cost of an asset should be assessed using the relevant Standards of GRAP. For example, where import duties are paid to acquire an asset within the scope of the Standard of GRAP on *Property,* *Plant and Equipment*, the levy may be considered an element of cost of the asset, and may meet the criteria to be capitalised.

Example 6—Levies payable to a collecting agent

Legislation may require an entity to collect levies on behalf of government. In such cases, the entity acts as an agent of government by collecting payments and remitting them to government. Entity E is an airports company that charges airport taxes to passengers on each air ticket purchased. Included in airport taxes are all charges, costs and taxes recovered through the air ticket. None of these levies accrue to Entity E.

In this example, the cash flows collected by Entity E and remitted to government are not within the scope of this Interpretation of the Standards of GRAP because it acts as an agent. However, from the perspective of the entity that makes the payment to Entity E for the air tickets for passengers travelled, the payment of the airport of taxes is considered a levy imposed by government that is within the scope of this Interpretation of the Standards of GRAP.

Basis for conclusions

The Basis for conclusions summarises the Accounting Standard Board's considerations in reaching consensus on the issues outlined in this Interpretation of the Standards of GRAP.

Background

BC1. When the Board considered the proposed GRAP Reporting Framework for 2014/15, it questioned the inclusion of IFRIC 21 on *Levies* (IFRIC 21) in the proposed reporting framework. The Board considered whether the IFRIC is in conflict with the principles in the Standards of GRAP, and if it is not in conflict, then the development of a local equivalent should be considered. It was concluded that the IFRIC is not in conflict with existing principles in the Standards of GRAP, and that an Interpretation of the Standards of GRAP should be developed, using the IFRIC as a basis, to provide guidance on the recognition of a liability to pay a levy that is accounted for in accordance with the Standard of GRAP on *Provisions, Contingent Liabilities and Contingent A*ssets.

Scope

BC2. While the title of this Interpretation of the Standards of GRAP could imply a limited scope, during the Board's initial research, it identified a variety of payments imposed by government which are not described as a "levy". The Board agreed that entities should consider the nature of the payment rather than the use of the term "levy" when considering transactions that are in the scope of the this Interpretation of the Standards of GRAP. Therefore, the substance of the transaction, rather its legal form, should prevail when assessing the scope of payments imposed by government.

BC3. The Interpretation of the Standards of GRAP defines a levy as the outflow of resources from an entity imposed by a government in accordance with legislation or similar means, other than payments that:

- are within the scope of other Standards of GRAP;
- are made in exchange for assets or the provision of goods or services in an exchange transaction;
- are imposed for breaches of legislation or similar means; and
- arise from emission trading schemes.

Payments within the scope of other Standards of GRAP

BC4. The IFRIC excludes from its scope, payments within the scope of other Standards such as income taxes. While the scope exclusion is relevant in the public sector, the Board agreed to expand this scope exclusion to include transactions that are addressed in a Standard of GRAP, for example employee-related expenses where the Standard of GRAP on *Employee Benefits* applies. The Board considered an example where an entity pays a levy to government based on salaries paid to employees. Such a payment is not in the scope of the Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets*, as that Standard excludes provisions dealt with in other Standards. As a result, this is not considered a levy for purposes of this Interpretation of the Standards of GRAP.

Payments made in exchange for assets or the provision of goods or services

BC5. The Board considered the scope and agreed that the scope exclusion should not be limited to the exchange of assets or provision of goods or services from contractual agreements. The Board observed that in the public sector there may be instances where assets or goods and services are exchanged as a result of legislation or similar means. The Board agreed that the scope exclusion should refer to binding arrangements instead of being limited to contractual agreements.

BC6. The Interpretation of the Standards of GRAP does not address payments made in exchange for assets or the provision of goods or services in an exchange transaction. In the light of the payments identified during the initial research, it was agreed that the Interpretation of Standards of GRAP should make a clear distinction between exchange and non-exchange transactions. Generally, exchange transactions are executory in nature as they require performance by both parties to the transactions. As such, it is easier to determine the timing and recognition of exchange transactions, as these will be triggered by the performance of the parties to the transaction. In contrast, non-exchange transactions do not require counter performance and entities often have difficulties identifying the point of recognition for non-exchange transactions. For this reason, the Interpretation of the Standards of GRAP is only applied to levies that are non-exchange transactions.

BC7. Payments imposed by government could include those payments that are imposed by government but are payable to third parties i.e. collecting agents. The Board agreed that, where an entity makes a payment to an agent collecting levies on behalf of government, an entity should consider whether the payments are imposed by government pursuant to legislation or similar means when determining if this

Interpretation of the Standards of GRAP should be applied. While there may not be a direct exchange between an entity and the government, an entity still assesses whether the underlying transaction with government is an exchange or non-exchange transaction.

Treatment of Value-Added-Tax (VAT)

BC8. The Board considered whether Value Added Taxes (VAT) meets the definition of a levy in this Interpretation of the Standards of GRAP. VAT is raised for the government by requiring vendors to register and charge VAT on taxable supplies of goods or services, and permits those vendors to claim VAT on taxable goods and services purchased. The net amount is either paid to or received from the Revenue Authority. Entities therefore act as an agent in collecting and remitting VAT to the government. The Board is of the view that the transaction between the government and the collecting or remitting entity is not considered a levy for purposes of this Interpretation of the Standards of GRAP. In the case of entities that are not registered as a VAT vendor, the VAT paid is seen as part of the cost of the goods or services procured.

Comparison with the Interpretation of IFRS on *Levies* (IFRIC 21) (May 2013)

This Interpretation of the Standards of GRAP on *Liabilities to Pay Levies* (IGRAP XX) is drawn primarily from the Interpretation of IFRS on *Levies* (IFRIC 21). The main differences between this Interpretation and IFRIC 21 are as follows:

- The title of this Interpretation has been amended so that it is clear that the Interpretation deals with the payment of levies and not the receipt of levies.
- The scope of this Interpretation has been amended to reflect the distinction between non-exchange and exchange transactions.
- Explanatory guidance has been added that explains what a levy is in the context of the public sector.
- The examples in this Interpretation and the appendix to the Interpretation have been amended to explain the applicability of the principles in this Interpretation to the South African public sector.
- The transitional provisions included in this Interpretation are different to those included in IFRIC 21.