Project **New item for initial consideration**

Topic **IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment*—Recognition of a liability**

Introduction

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request to clarify whether, under certain circumstances, IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* should be applied by analogy to other levies charged for participation in a market on a specified date to identify the event that gives rise to a liability.
2. The submission identifies levies that have recently been introduced in certain jurisdictions. The submission asserts that those levies have a common feature 'in that they are payable only if the entity participates in its market on a specified date (the specified date)'.
3. The submission is reproduced in full in Appendix A to this paper.

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRS Interpretations Committee or the IASB. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*.

Interpretations are published only after the IFRS Interpretations Committee and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in IASB *Update*.

Purpose of the paper

4. The objective of this paper is to:
   (a) provide background information on the issue;
   (b) provide an analysis on the issue;
   (c) evaluate the issue by reference to the Interpretations Committee's criteria for taking an issue onto its agenda;
   (d) provide a recommendation to the Interpretations Committee that it should take the issue onto its agenda; and
   (e) ask whether the Interpretations Committee agrees with the staff's recommendation.

Background information

Practical situations described in the submission

5. The submission gives different examples of levies being introduced in various jurisdictions.
6. We have identified additional facts about some of the examples in the submission that we present in more detail in Appendix C to this paper. Those additional facts relate to the UK bank levy and the railway tax. Those levies have the following main features:
   (a) A charge for the UK bank levy is triggered if the entity is a qualifying banking entity (or has a qualifying banking entity within its group) at the end of the annual reporting period. The levy is measured by reference to the carrying value of equity and liabilities;
   (b) A charge for the railway tax is triggered if the entity is authorised to participate in its market on the first day of annual reporting period N. The amount of the tax is measured as a percentage of revenues in annual reporting period N-1.

Current IFRS literature

7. We reproduce for ease of reference in Appendix B the paragraphs from the standards that we used to perform our analysis.

Scope of the request

8. The submission notes that the levies are not determined by reference to taxable or net profit for the period. Consequently, they do not fall under the scope of IAS 12 *Income Taxes*. We agree with this conclusion.

The issue

9. The question raised in the submission is of the date of recognition of the liability. Related to this is also the question of recognition of the liability in an entity's interim financial reporting.

10. The question of analogy to IFRIC 6 is raised because the taxes given as examples in the submission all refer to the taxes being conditional on the entity existing, or participating in a particular activity, on a specified date, similar to the Waste Electrical and Electronic Equipment (WE&EE) decommissioning obligation which was the subject of IFRIC 6.

11. The challenge that making an analogy to IFRIC 6 appears to present, and hence the reason for the submission, is the view of the Interpretations Committee that was included in the Basis for Conclusions to IFRIC 6 that "a stated intention to participate in a market during a future measurement period does not create a constructive obligation for future waste management costs" (IFRIC 6, BC10). The impact of this view on some of the taxes referred to in the submission is included in the following analysis.

Staff's analysis

Consensus in IFRIC 6

12. We note that IFRIC 6 is an interpretation of IAS 37 and that paragraph 7 of IFRIC 6 states that it should be analogised to using IAS 8 if the fact pattern is consistent.

13. We also note that IAS 37 requires the recognition of a liability if there is an obligating event. An obligating event exists if there is a past event that gives rise to a present obligation from which the entity has no realistic alternative to settling.

14. We note that the charge addressed by IFRIC 6:

    (a) was levied solely on entities that operated in a particular market on one specified date, irrespective of whether they had operated in the market one day earlier;

    (b) was measured solely by reference to the entity's share of the market on that date; and

    (c) was an allocation, in a given year, of a pool of waste management costs of products that were manufactured in prior periods, potentially by other entities.

15. The Interpretations Committee reached a consensus that, in such circumstances, the obligation arises only if and when the entity participates in the market during the 'measurement period'. That 'measurement period' is described in paragraph 4 of IFRIC 6 as 'a period to be specified in the applicable legislation of each Member State'.

16. In addition, the Committee observed in paragraph 5 of IFRIC 6 that variations between jurisdictions of the length of the measurement period, how market share is measured, and the formula for computing the obligation affect measurement, and not the existence of the liability or the timing of recognition.

Analysis of the specifics of the consensus in IFRIC 6

17. We have identified in the following paragraphs the rationales for the decisions reached in IFRIC 6. The objective is to outline the specifics of the circumstances around the European Union's Directive on Waste Electrical and Electronic Equipment (WE&EE) that may arise as similarities or differences when analysing other levies.

18. We note that paragraph BC6 of the Basis for Conclusions on IFRIC 6 states that the past event was the 'making of sales during the measurement period'. By focusing on the link of the recognition of the liability to participating in the market during the measurement period, the IFRIC highlights the separation of the timing of the recognition of the liability from the timing of the production and sales of the older equipment, for which the WE&EE costs will be used to decommission. Paragraph BC6 also adds that that past event 'requires recognition of a provision […] <u>over</u> the measurement period' (emphasis added).

19. Paragraphs BC8-10 of the Basis for Conclusions on IFRIC 6 considered, but rejected, arguments that an obligation would arise earlier because an entity stated its intention to participate in a market during a future measurement period, hence had no realistic alternative to settling the obligation.

20. We note that this does not preclude the possibility that a constructive obligation may arise from other factors. Specifically, a question may be of whether a constructive obligation would arise earlier in the following situations:

    (a) an entity cannot withdraw from an activity unless notice is given for a set period of time before the date the entity no longer qualifies on the specified date;

    (b) an entity requires an authorisation to operate in a specific market and that authorisation is granted for a period longer than the annual financial reporting period.

General circumstances under which it may be appropriate to analogise to IFRIC 6

21. Analogy to IFRIC 6 would seem appropriate when:

    (a) an obligating event arises from a law or other government action/authority (i.e. not from a contract) and the entity has not made any statements that it will act beyond its obligations under the law (i.e. the entity has not created a constructive obligation); and

    (b) the law specifies that the obligation arises because of the entity's participation in an activity during a particular period.

22. We think that whether the consensus in IFRIC 6 should be applied by analogy depends on whether the relevant facts are sufficiently similar to those in IFRIC 6.

23. In this respect, the four illustrative examples given in the submission differ from each other. We therefore believe they should be considered individually.

Analysis of some specific examples from the submission

24. We provide the following analysis on the basis of our understanding of the fact patterns that have been communicated to us. If those facts are different, they may lead to a different analysis.

25. We consider below two of the illustrative examples in the submission:

    (a) the UK bank levy—paragraphs 26 to 33 of this paper; and

    (b) the railway tax—paragraphs 34 to 42 of this paper.

The UK bank levy

26. We have summarised our understanding of the main features of the legislation relevant to the accounting for the bank levy in Appendix C to this paper.

27. We note that the issue relating to the bank levy is principally an interim reporting issue.

28. On the question as to when to recognise a liability for the bank levy, we note that two views exist:

    (a) View A: the liability should be recognised only on the last day of the period; or

    (b) View B: the recognition of the liability should be progressive over the period.

29. Those in favour of view A argue that:

    (a) paragraph 14(a) of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* requires the existence of a present obligation that results from past event for the recognition of a non-financial liability;

    (b) paragraph 17 of IAS 37 states that the past event is an obligating event if the entity has no realistic alternative to settling the obligation;

    (c) paragraph 9 of IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* emphasises that participating in the market on a specified date is the obligating event and that a liability does not arise until that date;

    (d) in the specific fact pattern of the bank levy, there is no obligation to pay the levy until/unless the entity is a qualifying entity or has a qualifying entity within its group on the last day of the period;

    (e) IAS 34 *Interim Financial Reporting* requires that the principles for recognising liabilities and expenses in interim periods are the same as in annual financial statements (paragraphs 28 and 29 of IAS 34); and

    (f) the entity cannot use the argument at interim reporting dates that it has a constructive obligation for the levy. The argument that the entity has no realistic ability to cease to be a qualifying entity before the last day of the period in order to avoid the obligation is seen as being prevented by the views expressed in paragraph BC10 of IFRIC 6.

30. The consequence of view A is that because the charge for the UK levy is triggered by the entity being a qualifying entity on the last day of the financial

period, the full charge and liability is recognised on the last day, and no charge or liability is recognised at interim reporting dates.

31. Those in favour of view B argue that:

    (a) an essential feature of the bank levy is that it is a recurring, annual tax that is levied for a chargeable period. In support of this argument, they point to the fact that the amount of the levy is proportional to the length of the chargeable period, if the 'annual' financial period is shorter or longer than 12 months. However, we note that, should the entity cease to be a qualifying entity before the end of that period of account, the bank levy charge for the entity would be nil at the end of the period of account;

    (b) an entity can only withdraw from the bank activity under certain regulatory conditions. They therefore believe that in substance, a constructive obligation to operate 'at the end of a period of account' exists.

32. Another argument that can be made in support of view B arises from the guidance in IAS 34. Paragraph B7 of IAS 34 gives guidance on recognising a liability for contingent lease payments. The guidance describes a situation where an additional rent expense will arise at the end of the year if sales for the year exceed a certain value. At an interim reporting date, if the cumulative sales threshold has not been met, but there is a reasonable expectation that the threshold will be met by the end of the year, then an obligation for additional rent expense is recognised in the interim financial report. The bank levy has some similarities with the example in paragraph B7; at the interim date, the trigger for the charge has not been reached, but nonetheless, the entity meets the definition of a qualifying entity as set out in the legislation. The entity has no realistic possibility of avoiding the obligation because to do so would require actions by the entity for which the possibility of it being able to take those action is remote (or less than remote).

33. Those in support of view B note that the fact that the bank levy is charged on the basis of the chargeable liabilities and equity at the end of the period of account is relevant to the **measurement** of the liability rather than to its

recognition. An entity would therefore estimate the liability at the interim date by considering the basis of the calculation required by the legislation and the information available to the entity at the interim reporting date..

Railway tax

34. We have summarised our understanding of the main features of the legislation relevant to the accounting for the railway levy in Appendix C to this paper.

35. We note that the issue for the railway tax is not just one related to interim reporting, but also a question about which annual reporting period the railway tax should be recognised in. The following analysis therefore focuses on the annual reporting question, rather than the interim reporting question.

36. We note that the two following opposing views exist:

    (a) View 1: a liability should be recognised at the end of annual reporting period N-1.

    (b) View 2: no obligation exists before 1 January N for the tax measured on revenue for the immediately preceding annual financial reporting period (N-1).

37. The railway levy is proportional to the activities of the entity (it is calculated as a percentage of revenue) and charged annually.

38. Paragraph 14(a) of IAS 37 requires that a present obligation exists. We note that paragraph 4.15 of *The Conceptual Framework for Financial Reporting 2010* defines an obligation as 'a duty or responsibility to act or perform in a certain way'.

39. Under the European Union Railway Safety Directive (2004/49/EC) the safety certificate is granted for 5 years. Consequently, authorisations to operate are delivered to railway companies for a period longer than an annual financial reporting period. It can be argued that this authorisation creates a duty or a responsibility for the entity to operate as a railway company throughout the authorisation period.

40. In other words, the railway levy is a periodic charge that arises annually from activity over the preceding annual period, rather than being expenditure to operate in a particular way in the future.

41. Proponents of view 1 argue that it is certain at the end of annual reporting period N-1 that the entity will operate on 1 January N. They advocate that the entity has a constructive obligation to pay the levy continuously as it operates because the tax is based on the entity's activity in N-1.

42. Those in favour of view 2 rely on paragraphs 14 and 19 of IAS 37 to assert that the obligating event does not exist before 1 January N. They argue that because the entity can choose not to operate on the 1 January N, it has no present obligation to pay the levy.

Further staff observations

43. We note that the arguments against recognising a liability for the bank levy or railway tax rely to some extent on requiring the entity to make an assumption that it will cease a particular business activity and as a result avoid the liability. We note that this is much more significant than, for example, requiring an assumption about avoiding a liability under an individual contract as a result of exercising an option available to the entity under that contract.

44. We have two concerns over the use of an assumption that the entity will cease a particular business activity for the purposes of whether to recognise this liability:

    (a) the assumption is not consistent with management's expectations, whether or not public statements have been made about their expectations; and

    (b) the assumption is inconsistent with the going concern assumption used for recognising and measuring other elements of the financial statements, such as measurement of impairment of assets used in this business activity, or the non-recognition of closure costs.

45. The argument that such an assumption should be made is in part driven by the views expressed in paragraph BC10 of IFRIC 6. If the Committee decides to

take this issue onto its agenda, we recommend that the circumstances in which making such an assumption is appropriate are also considered by the Committee and, if necessary, a clarification made.

Agenda criteria assessment

46. Our assessment of the Interpretations Committee's agenda criteria is as follows:

(a) *The issue is widespread and has practical relevance.*

We note that issues on the recognition of liabilities for levies arise in several jurisdictions. Those levies all have different features that may lead to different accounting treatments depending on the assessment of each set of facts and circumstances against the requirements in IAS 37. However, given the prevalence of these types of taxes, there may be some common features that could be identified for which a project could be added to the Committee's agenda.

(b) *The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice). The Committee will not add an item to its agenda if IFRSs are clear, with the result that divergent interpretations are not expected in practice.*

We note that, although the principle in paragraph 14 of IAS 37 seems clear as to when to recognise a liability, application of that paragraph raises questions in several jurisdictions. The two key challenges appear to be:

(i) determining whether the obligating event is the participation in an activity on the date specified by the legislation, or whether other factors create an earlier obligation; and

(ii) when the obligating event arises in the current annual period, determining the circumstances when an appropriate portion of the charge can be accrued at the interim reporting date.

(c) *Financial reporting would be improved through elimination of the diverse reporting methods.*

Yes.

(d) *The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process.*

We note the diversity of fact patterns for levies across jurisdictions and the potential adverse effect on an efficient solution. However, we believe that there are benefits of performing further outreach activities to try and draw out some common features for levies other than income taxes.

(e) *It is probable that the Committee will be able to reach a consensus on the issue on a timely basis.*

Yes.

(f) *If the issue relates to current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project? (The IFRIC will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the IFRIC would require to complete its due process).*

The project on the revision of IAS 37 is currently at a standstill and further deliberations on this project are not anticipated until later in 2011.

Staff's recommendation

47. We note that the levies presented in the submission are all different. Whether and how the consensus in IFRIC 6 would apply to them could vary depending on the facts of each levy. We therefore believe that preparers need to consider the similarities and differences and consider how the requirements of IAS 37, as applied in IFRIC 6, would apply in each case.

48. However, we note that the two key challenges appear to be:

    (a) determining whether the obligating event is the participation in an activity on the date specified by the legislation, or whether other factors create an earlier obligation; and

    (b) when the obligating event arises in the current annual period, determining the circumstances when an appropriate portion of the charge can be accrued at the interim reporting date.

49. We think that, given the mixed views on the appropriate accounting treatment, the Committee should consider whether further guidance could be given to address this diversity and consequently, we recommend that the Committee should take the issue onto its agenda.

50. In support to our recommendation we reproduce in Appendix D to this paper a note from the UK Accounting Standards Board on the UK bank levy. It should be noted that that note is a staff summary of the ASB's discussion on accounting for the UK Bank Levy. It has not been seen or approved by the ASB members.

Question to the Interpretations Committee

Question—staff's recommendation
(1) Does the Interpretations Committee believe that the identified challenges in paragraph 44 of this paper should be addressed?   (2) Does the Interpretations Committee agree with the staff's recommendation?

Appendix A—Submission

Submission to the IFRS Interpretations Committee

IFRS IC POTENTIAL AGENDA ITEM REQUEST

IAS 37, Provisions – Identification of the obligating event

IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment: Application by analogy to levies charged for participation in a market on a specified date

Background

Several jurisdictions have recently introduced levies on entities operating in specific industries, for example banking, insurance and railways. A common feature of several of these levies is that they are payable only if an entity participates in its market on a specified date ("the specified date"). For example, some levies are calculated as a percentage of revenues in Year 1 but are payable only if the entity participates in its market on the first day of Year 2. Others are determined by reference to the carrying value of assets or liabilities at the end of the financial year. The specified date, which determines whether the tax is paid, is usually at the beginning or the end of a calendar or financial year.

The levies addressed in this request are not determined by reference to taxable or net profit and are therefore not in the scope of IAS 12. The obligation to pay the levy is recognised and measured in accordance with IAS 37.

The issue

There are different views about whether the obligating event is participation in the market during the period prior to the specified date or being in business on the specified date. There is consequently diversity in views about when the obligation to pay the levy is recognised and whether the guidance in IFRIC 6 should be applied by analogy.

There is concern that applying IFRIC 6 by analogy disconnects the recognition of the liability from the activities to which the levy relates, particularly when the entity has no realistic alternative but to remain in the market on the specified date. For example, a railway operator might be required to pay a levy based on revenues in Year 1, but only if the entity participates in its market on 1 January Year 2. Applying IFRIC 6 by analogy would delay recognition of the obligation until 1 January Year 2. This does not appear to reflect the substance of the levy as the operator has no realistic alternative but to continue in the market. There are also many situations in which an entity expects and intends to remain in the market until the specified date and has created an expectation that it will continue in the market.

The alternative views

<u>View 1A: Analogy to IFRIC 6; provision recognised in full on the specified date</u>

IFRIC 6.9 states that 'participation in the market during the measurement period is the obligating event in accordance with paragraph 14(a) of IAS 37.' Therefore there is no obligation to pay the levy until the entity participates in the market on the specified date, which is when the levy is

recognised, even though the levy might be measured by reference to revenues in the previous period.

Some argue that an entity might not be able to avoid participating in the market at the specified date or might intend and expect to continue operating. The entity therefore has a constructive obligation at an earlier date. IFRIC 6.BC10 rejects this argument, stating that 'a provision can be recognised only in respect of an obligation that arises independently of the entity's future actions...Consequently, no obligation exists...until the entity participates in the market during the measurement period.'
IAS 37.14 therefore precludes recognition of a liability for the levy until the specified date, even if this is after the end of the period in which activities on which the levy is based occurred. A provision for the full amount of the levy is recorded as a liability and an expense on the specified date.

View 1B: Analogy to IFRIC 6; provision recognised prospectively over the subsequent accounting period

Consistent with view 1A, the obligating event is participation in the market on the specified date. However, the substance of the levy is an annual charge for participation in the market and the expense is therefore recognised over the accounting period beginning on the specified date.

A prepayment is recognised at the same time as the liability and is amortised over the subsequent twelve months, reflecting consumption of the economic benefits to which the entity is entitled by being allowed to participate in the market. The prepayment is recognised even if the levy is not refundable because the substance is an annual charge for the right to do business.

View 2: No analogy to IFRIC 6; provision recognised progressively throughout the period

IFRIC 6 applies specifically to liabilities for waste management under the EU directive on waste electrical and electronic equipment. It should not be applied by analogy in different circumstances.

An entity might have no realistic alternative but to remain in its market until the specified date (and possibly beyond). For example, an entity might be bound by the terms of a license or other contractual terms to continue to operate. The costs of exiting the market might be so high that the entity cannot realistically exit the market and continue as a going concern. The requirement to participate in the market on the specified date is not substantive in these circumstances, so the entity creates a constructive obligation to pay the levy as it operates.

An entity should recognise a constructive obligation to pay the levy if it cannot realistically exit the market or if it intends and expects to remain in the market and has made that intention clear. The substance of the levy is a charge on entities operating during the period prior to the specified date. The obligation to pay the levy and the related expense are therefore recognised progressively throughout the year and reflect the measurement basis for the levy at each interim reporting date. The obligation for a levy based on revenue is measured by reference to revenues earned in an interim period. The liability for a levy based on assets or liabilities is measured by reference to the expected carrying values on the balance sheet at the specified date, time apportioned by reference to the interim period.

IASB Staff paper
Appendix A

Reasons for the IFRS IC to address the issue:

We believe that the IFRS Interpretations Committee should clarify the extent to which IFRIC 6 should be applied by analogy because:

- there are diverse interpretations and approaches in practice; and
- accounting by analogy to IFRIC 6 does not reflect the economic substance of some obligations.

The approach required by IFRIC 6 is simple, but does not recognise that in many cases an entity has no realistic opportunity to withdraw from a market before the legal obligation arises.

When an entity has no realistic alternative but to remain in the market or expects and intends to remain in the market and incur the levy, IFRIC 6 does not reflect the substance of the levy. Progressive recognition throughout the reporting period under view 2 results in recognition of an expense in the period to which it relates and would be better understood by users.

Appendix: Illustrative examples

1. Railway turnover levy in France

A new tax was implemented in France just before 31 December 2010. The tax only applies to railway activities. It is payable by entities that are in the market on 1 January 2011 and is a percentage of the prior year's turnover. This tax is a recurring tax and will be charged each financial year.

2. Turnover levy for all activities in France (Contribution sociale de solidarité des sociétés)

This levy was introduced in 1970. It is payable by entities that realise an annual turnover higher than 760 000€ in year Y and that exist on 1 January. The levy is determined as a percentage of turnover.

3. UK banking levy

The UK government has introduced legislation for a levy on banks and other financial institutions. For banks and building societies, the levy is based on the sum of certain categories of financial liabilities and equity ("chargeable liabilities"). A fixed percentage is applied to the total of the chargeable liabilities at the entity's balance sheet date. As a matter of practicality, the levy is collected as part of the corporation tax regime and is therefore paid in 4 instalments falling due in months 7, 10, 13 & 16 after the start of the financial year to which the levy relates.

This levy is a recurring levy, charged each financial year to all entities within a defined sector whose chargeable liabilities meet certain size criteria. If an entity's financial year is longer or shorter than 12 months (for example, where a change in financial year occurs), the levy is pro-rated to reflect the increased or decreased number of days in the reporting period.

4. Hungarian bank tax

On 22 July 2010, the Hungarian Parliament passed a Bill introducing a special tax (or “bank tax”, as it is generally known), which is payable by a wide range of financial organisations, including banks, insurance companies, investment funds, and other financial services companies.

The calculation base and percentages vary between types of entities. For example for banks, taxes are payable based on adjusted balance sheet total, while the tax base for insurers is the adjusted premium income. The tax was introduced for three years and is currently scheduled to expire as of 1 January 2013. The tax for all three years is calculated using 2009 financial data. Any financial services company that is in operation as of 1 January 2011 and 2012 is liable for payment of the full amount of banking tax for the respective years, even if they terminate all activities later during the year. In some highly regulated industries (for example, banking and insurance) exiting the Hungarian market is extremely complicated and time consuming, therefore in most cases avoiding the tax payment by exiting the market is not a practical option.

Appendix B—relevant IFRS literature

Extracts from IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

14 A provision shall be recognised when:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision shall be recognised.

17 A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only:

(a) where the settlement of the obligation can be enforced by law; or

(b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation.

19 It is only those obligations arising from past events existing independently of an entity's future actions (ie the future conduct of its business) that are recognised as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the entity. Similarly, an entity recognises a provision for the decommissioning costs of an oil installation or a nuclear power station to the extent that the entity is obliged to rectify damage already caused. In contrast, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.

Extracts from IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment*

9 Participation in the market during the measurement period is the obligating event in accordance with paragraph 14(a) of IAS 37. As a consequence, a liability for waste management costs for historical household equipment does not arise as the products are manufactured or sold. Because the obligation for historical household equipment is linked to participation in the market during the measurement period, rather than to production or sale of the items to be disposed of, there is no obligation unless and until a market share exists during the measurement period. The timing of the obligating event may also be independent of the particular period in which the activities to perform the waste management are undertaken and the related costs incurred.

BC8 The IFRIC considered whether its conclusion is undermined by the principle that the entity will continue to operate as a going concern. If the entity will continue to operate in the future, it treats the costs of doing so as future costs. For these future costs, paragraph 18 of IAS 37 emphasises that 'Financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future.'

BC9 The IFRIC considered an argument that manufacturing or selling products for use in private households constitutes a past event that gives rise to a constructive obligation. Allocating waste management costs on the basis of market share would then be a matter of measurement rather than recognition. Supporters of this argument emphasise the definition of a constructive obligation in paragraph 10 of IAS 37 and point out that in determining whether past actions of an entity give rise to an obligation it is necessary to consider whether a change in practice is a realistic alternative. These respondents believed that when it would be necessary for an entity to take some unrealistic action in order to avoid the obligation then a constructive obligation exists and should be accounted for.

BC10 The IFRIC rejected this argument, concluding that a stated intention to participate in a market during a future measurement period does not create a constructive obligation for future waste management costs. In accordance with paragraph 19 of IAS 37, a provision can be recognised only in respect of an obligation that arises independently of the entity's future actions. For historical household equipment the obligation is created only by the future actions of the entity. If an entity has no market share in a measurement period, it has no obligation for the waste management costs relating to the products of that type which it had previously manufactured or sold and which otherwise would have created an obligation in that measurement period. This differentiates waste management costs, for example, from warranties (see Example 1 in the guidance on implementing IAS 37), which

represent a legal obligation even if the entity exits the market. Consequently, no obligation exists for the future waste management costs until the entity participates in the market during the measurement period.

Appendix C—Additional information gathered on the examples in the submission

UK bank levy—information from Schedule 19 of the Finance (n°3) Bill for 2011

C1. Currently, draft legislation in the UK sets out future requirements for a levy that would be charged on UK banks for periods of account ending on or after 1 January 2011. The amount of the levy is based on the value of certain types of the banks' liabilities and equity as at the last day of the annual financial reporting period. The draft legislation was published in Schedule 19 as part of the Finance (n° 3) Bill 2011.

C2. We reproduce below paragraph 4 of Schedule 19 as presented in the Finance (n°3) Bill for 2011 that sets out the framework of the banks' obligation:

> (1) The bank levy is charged if, as at the end of a period of account ("the chargeable period") of an entity ("the parent entity")
>
> (a) the parent entity is a parent and is not a subsidiary of any other entity, and
>
> (b) the group ("the relevant group") for which the parent entity is the parent is a group within sub-paragraph (2).

C3. From our reading of the detailed documentation on the UK bank levy in Schedule 19, we have identified the following items in connection with the analysis of the timing of recognition of the liability:

(b) the levy is charged on a 'specified date' (paragraph 4(1) of Schedule 19);

(c) the specified date is 'the end of a period of account', also referred to as 'the chargeable period' (paragraph 4(1) of Schedule 19);

(d) 'a period of account' in relation to an entity is defined as a period for which the entity prepares financial statements (consolidated or otherwise) (paragraph 69(1) of Schedule 19);

(e) references to consolidated financial statements for a period include references to a […] consolidated statement of financial position as at the last day of the period (paragraph 41(2) of Schedule 19); and

(f) if the chargeable period is not 12 months, then measurement is proportional to the length of the period (paragraph 6(2) step 6 of Schedule 19).

C4. The levy is charged at the end of a period of account, but some instalments are paid before this date on the basis of an estimate of the amount that will be payable.

C5. If the bank does not have chargeable liabilities exceeding £20 billion at the end of the relevant period of account, it will not be liable to pay any tax.

C6. We note that the legislation is expected to be enacted in July 2011.

Railway taxes

C7. The 'loi de finance pour 2011' (the Finance Bill) in France imposes a new tax (referred to as the CST) from 1 January 2011. This tax has the following features:

(a) it is due from railway entities that are authorised to operate the railway network on 1 January N; and

(b) its amount is measured based on revenue for the immediately preceding annual financial reporting period, ie N-1.

C8. The European Union Railway Safety Directive requires that a railway company must obtain a safety certificate from the relevant authorities to operate on the railway network. That certificate is granted for a five-year period and authorises the entity to operate the railway network.

C9. The safety certificate must be renewed upon application by the railway undertaking at intervals not exceeding five years. It must be wholly or partly updated whenever the type or extent of the operation is substantially altered.

Appendix D—Staff summary of key points arising from ASB Discussion on 14 April 2011

1.1 The accounting for UK Bank Levy was identified as an issue to be considered by the ASB. The Board was notified of the difference in views among constituents on how to account for the liability arising from the levy. Some were advocating a pure technical accounting answer by analogy to IFRIC 6, i.e. only recognise the liability at the year end when it could be calculated as a percentage of the year-end "chargeable equity and liabilities". Others advocated consideration of the substance of the levy and applying a commonsense approach of accruing it over the year.

1.2 It was noted that the logic of IFRIC 6 was that, whatever the expectation, an entity only had a liability if it was actually in the market for electrical goods the following year, and on that basis it was decided that no provision should be made. Similarly, if an entity was no longer a bank on 31 December, it would have no liability at the year end.

1.3 The following was considered during the ASB's discussion on this topic:

a. The HMRC treatment of the Levy is the same as that for any other tax and means that banks would have to make payments during the year through the Quarterly Instalment Payments System (QIPS), based on their estimate of year-end balances. Not accruing for the levy at quarter ends would mean treating these payments as assets, which would only be recoverable if the bank's Balance Sheet shrunk to zero before the year end.

b. It was likely that the legislation would only be passed in the third quarter, which meant that for 2011 at least the issue only arose for banks' third quarter results.

c. It was noted that the banks in question were of the view that the right accounting was to accrue the liability and expense as part of the tax charge. It was also noted that users wanted the accounting to reflect the substance of the underlying transaction.

d. Concerns were raised that a conclusion might be reached that was technically pure but which made no sense to users – this was the sort of thing standard setters were being criticised for. It was noted that no one thought it made sense not to accrue the levy.

e. Some Board members were of the view that without IFRIC 6, it would be possible to get to the right answer under IFRS, but the analogy to IFRIC 6 might make getting to the right answer more difficult.

f. Another argument was noted that because the levy was calculated on the year-end liabilities (with some window-dressing provisions), it could not be determined before that date. But some Board members

were of the view that this could be argued as only relating to the measurement of the levy, not the existence of the liability.

g. Some Board members noted that it was about the substance of the liability. It was clear that the banks would continue to be a bank at the year end, and that the levy would be payable. An argument was raised that if the bank went bust before the year end, the prepaid levy would be repayable. But this was considered to be part of the going concern presumption

1.4 The Board also considered whether the true and fair override could or should be applied in the quarterly accounts on the basis that it would sound ridiculous for a bank to have to explain that it had not provided for the levy because it might no longer be a bank on 31 December. It was also noted that the true and fair override was in EU legislation, and the counsel's opinion the FRC had obtained was clear that a true and fair override was still available under EU-adopted IFRS.

1.5 It was agreed to await the results of the IFRIC consideration before considering this further

It should be noted that the above is a staff summary of the ASB's discussion on accounting for the UK Bank Levy. It has not been seen or approved by the ASB members.