Project **Item for continuing consideration**

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

Topic **Interim reporting issue**

Purpose of the paper

1. The objective of this paper is to set out our analysis of the interim reporting issue for some levies.

Description of the issue

2. In one of the situations that were reported to us, the activity date/period and the calculation date/period are in the same annual financial reporting period. The critical issue in this circumstance is the accounting in interim reporting periods; should the liability for the levy be recognised throughout the reporting period or in full on one date?
3. The issue arises when, for example, the legislation is constructed in such a way as to identify one specific date during the financial year that triggers the obligation based on the entity meeting the qualifying criteria on that date.
4. One example of this is if the focus is on participation in a particular activity on the last day of the financial year; should a charge for the full levy be recognised only that last day, or should the charge be recognised rateably over the financial year?

5. Another example is if the focus is on participation in a particular activity on the first day of the financial year; should a charge for the full levy be recognised on that first date, or should the charge be recognised rateably over the financial year? In the related example of the fees paid to the Federal Government by pharmaceutical manufacturers in the USA, a consensus was reached over the following accounting treatment as set out in EITF 2010-27:

   (a) The full liability for the levy is recognised on the first day of the financial year;

   (b) An asset is recognised for the full amount of the liability on the first day of the financial year; and

   (c) The asset is amortised over the financial reporting period.

Analysis of the issue

Applicable literature

6. IAS 34 *Interim Financial Reporting* provides the following general guidance for the preparation of interim financial reports in paragraph 28:

   > An entity shall apply the same accounting policies in its interim financial statement as are applied in its annual financial statements….However, the frequency of an entity's reporting (annual, half-yearly, or quarterly) shall not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes shall be made on a year-to-date basis.

7. Appendix B to IAS 34 provides illustrative examples and guidance on applying the general recognition and measurement principles set out in IAS 34. These include guidance on provisions and year-end bonuses, that are reproduced in Appendix A to this paper.

Views identified in relation to the interim financial reporting issue

8. In relation to the situation described in paragraph 4 above, we note that paragraphs 26 to 33 of agenda paper 15 that was presented to the Committee at

the May 2011 meeting listed arguments for the following divergent views on the accounting at interim financial reporting periods:

(a) View A: the liability and the corresponding charge should be recognised in full only on the specific day identified in the legislation; or

(b) View B: the recognition of charge to profit or loss should progressive over the period.

Staff analysis

9. The accounting requirements for a levy depend on the specific terms of the levy. The following analysis considers certain characteristics that may help to serve as indicators when identifying the appropriate accounting.

Qualification at interim reporting date

10. The primary question that the submission raises is whether there is a basis for recognising a liability at the interim reporting date.

11. Where the legislation refers to a relative date, such as the end of the reporting period, rather than a specific date, such as 31 December, consideration should be given to whether the entity already meets the criteria to be liable for the levy at the interim reporting date.

12. Some levies are payable if an entity participates in a particular activity and the amount of the levy is calculated by reference to a financial measure on the last day of the reporting period. In circumstances where the entity meets all of the relevant criteria at the interim reporting date then the levy would be payable if the interim reporting date was the year-end reporting date. It is arguable that in these circumstances a liability should be recognised at the interim reporting date.

Levy for a period of time

13. The analysis presented in paragraphs 10 to 12 above considers the levy from the perspective of the balance sheet. We think a further analysis is of the levy

reflecting a charge for the period relating to the consumption of economic benefits associated with the rights conferred by the payment of the levy.

14. The focus of the legislation on a single date for qualification purposes and/or measurement purposes is, on the face of it, an indicator that the unit of account from a time perspective is that single date. However, when the levy is charged annually, then it raises the question as to whether the levy is a charge over a period.

15. Levies, and other similar taxes, may sometimes be linked to the grant of a right by the government to participate in a market/carry on an activity. Where there is a right granted to an entity in return for the levy that is charged, then it is arguable that the cost of that levy should be recognised in profit or loss over the period in which the entity benefits from that right.

16. A feature that, if present, might indicate that a levy relates to a period of time rather than a single date, is if the levy charged is pro-rated according to, for example, the length of the reporting period.

17. Indicators relating to the period of time to which the levy relates can be summarised as follows:

Indicators that a levy relates to a point in time	**Indicators that a levy relates to a period of time**
• Focus of legislation for qualification purposes is on a single date • Measurement of levy relates to circumstances on a single date • No variation in amount payable if reporting period is shorter than or longer than 1 year	• Levy is charged on a recurring basis, for example annually • Measurement of levy relates to circumstances over a period of time (e.g. profit for a period of time) • Amount payable varies pro-rata to the length of the reporting period

18. That in the circumstances described in paragraph 12 of this paper a liability should be recognised at the interim reporting date is considered to have greater weight for those levies which are pro-rated according to the length of the reporting period. For these levies, if the reporting period was shortened such that the interim reporting date became the year-end reporting date, there would be no doubt that there is a liability to recognise.

Analysis against the guidance in IAS 34

19. The general principle in IAS 34 is that the same accounting policies should be applied in the interim financial statements as in the full year financial statements, and that measurement at the interim reporting date should be made on a year to date basis.

20. The illustrative examples in Appendix B of IAS 34 (see Appendix A to this paper) explain that in the case of provisions, a provision should be recognised at an interim date as it would at the end of the entity's financial year. In addition, in the case of year-end bonuses, paragraph B6 of the Illustrative Examples to IAS 34 provides for the necessary conditions for anticipating the bonus for interim reporting purposes:

    (a) the bonus is a legal obligation or past practice would make the bonus a constructive obligation for which the entity has no realistic alternative but to make the payments; and

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

21. In the light of these two illustrative examples (provisions and year-end bonuses) we believe that the indicators listed in paragraph 17 of this paper that the levy relates to a period of time would lead to an accounting treatment similar to the one that would reflect an anticipation of year-end bonuses for interim reporting purposes.

22. Consequently, we are of the opinion that the consequence of applying paragraph 28 of IAS 34 is that accrual is needed at interim dates in the specific circumstances described by the combination of:

    (a) the indicators listed in paragraph 17 of this paper that the levy relates to a period of time; and

    (b) facts and circumstances being the same at the end of the interim reporting date as they are at the end of the annual financial reporting period.

Conclusion on reporting in interim financial periods

23. Constituents expressed concern over the tension that was identified for the recognition of a liability with respect to the interaction between:

(a) a date on which an entity falls within the scope of a levy in a reporting period; and

(b) whether recognition of the levy should be progressive over the period.

Consequently, we recommend that the Interpretations Committee should propose an amendment to IAS 34 that would clarify that, in circumstances where the combined factors listed in paragraph 22 above are present, a liability should be accrued in interim financial reporting periods.

Agenda criteria assessment

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

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

We observe diversity of views in situations in which the focus is on participation in a particular activity on the last day of the financial year as to whether a liability arises at interim dates.

(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. Specifically, difficulties arise when the obligating event arises in the current annual period, determining the circumstances in which 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.*

Though levies present a diversity of fact patterns, we observe that the features are analysed in different ways.

(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).*

There is no current Board project that relates to a revision of IAS 34.

Staff's recommendation

25. As expressed in paragraph 22 of this paper, we recommend that the Interpretations Committee should propose an amendment to IAS 34 that would clarify that in circumstances where the combined factors listed below are present a liability should be accrued in interim financial reporting periods:

(a) the unit of account for the levy is any reporting period, and the charge is a charge for the period; and

(b) the entity is within the scope of the levy at the interim date and facts and circumstances are the same at the end of the interim reporting date as at the end of the annual financial reporting period.

Question to the Interpretations Committee

26. Consistently with the recommendations in paragraph 25, we have the following question for the Interpretations Committee:

Question—staff's recommendation
(1) Does the Interpretations Committee agree with the staff's conclusion summarised in paragraph 25 of this paper? (2) Does the Interpretations Committee agree with the staff's recommendation to take the issue onto its agenda?

Appendix A—excerpts from Illustrative Examples to IAS 34 *Interim Financial Reporting*

Provisions

B3 A provision is recognised when an entity has no realistic alternative but to make a transfer of economic benefits as a result of an event that has created a legal or constructive obligation. The amount of the obligation is adjusted upward or downward, with a corresponding loss or gain recognised in profit or loss, if the entity's best estimate of the amount of the obligation changes.

B4 This Standard requires that an entity apply the same criteria for recognising and measuring a provision at an interim date as it would at the end of its financial year. The existence or non-existence of an obligation to transfer benefits is not a function of the length of the reporting period. It is a question of fact.

Year-end bonuses

B5 The nature of year-end bonuses varies widely. Some are earned simply by continued employment during a time period. Some bonuses are earned based on a monthly, quarterly, or annual measure of operating result. They may be purely discretionary, contractual, or based on years of historical precedent.

B6 A bonus is anticipated for interim reporting purposes if, and only if, (a) the bonus is a legal obligation or past practice would make the bonus a constructive obligation for which the entity has no realistic alternative but to make the payments, and (b) a reliable estimate of the obligation can be made. IAS 19 Employee Benefits provides guidance.