STAFF PAPER

IFRS Interpretations Committee Meeting

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Project	**Levies charged for participation in a specific market – Date of recognition of a liability**		
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Purpose of the paper

1. This paper discusses when a liability for the obligation to pay a levy should be recognised in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Specifically, this paper discusses the following matters:

   (a) Does economic compulsion create a constructive obligation?

   (b) Does the going concern principle affect the timing of recognition of the liability?

   (c) Can there be multiple obligating events and if so, which one gives rise to a liability?

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

   (e) Should a liability to pay a levy charged for participation in a specific market be recognised when the entity is required to participate in that specific market in future period(s)?

Does economic compulsion create a constructive obligation?

2. For annual levies charged for participation in a specific market, some argue that an entity might in practice have no realistic alternative other than to continue operating in the market in the next reporting period. In other words, some argue that when it would be necessary for an entity to take some unrealistic action in order to avoid the obligation (ie to withdraw from the market), then a constructive obligation to pay the levy triggered in the future period exists and should be accounted for.

3. The following example illustrates the issue:

> Example A: The legislation imposes an annual levy for each calendar year for entities participating in a specific market. The levy is due if entity E generates revenues in that specific market in 2011. The amount of the levy is determined by reference to revenues generated by entity E in the market in the preceding year (ie 2010). The levy arising from the activity in the specific market in 2011 is payable in full in April 2012. Entity E participates in the specific market on 1 January 2011. In this example, the calculation period (ie 2010) precedes the activity period (ie 2011).

4. The question is whether Entity E has a constructive obligation at year end 2010 to pay the levy triggered in 2011. In order to deal with this issue, we will consider in this section both the requirements in IAS 37 and the consensus in IFRIC 6.

IAS 37 requirements

5. According to IAS 37 (paragraph 10):

> A constructive obligation is an obligation that derives from an entity's actions where:
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> (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and

> (b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

6. IAS 37 (paragraph 17) specifies that:

> 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:
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> (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.

7. Paragraphs 18 and 19 of IAS 37 also state that no provision is recognised for costs that need to be incurred to operate in the future or when the obligation does not exist independently of the entity's future actions. IAS 37 provides several examples to illustrate this issue.

> 18. 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.
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> 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.

Illustrative Example 6: Legal requirements to fit smoke filters

8. IAS 37 (IE6) provides an example of an entity that is required to fit smoke filters to its factories (because of legal requirements or commercial pressures).

9. 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 the future expenditure.

10. IE 6 goes on to say that if legislation exists but the enforcement date has not yet been reached, there is no obligation. If the enforcement date has been reached, there is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation.

11. We observe that IAS 37 did not conclude that there is a constructive obligation to fit the filters, even if some could argue that:

    (a) it is economically unrealistic for the entity not to incur the expenditure if it has an intention of continuing in business;

    (b) the entity has in certain cases created valid expectations on the part of customers that it will comply with the legislation and will continue in business, including the entering with, for example, contracts for future sales to customers.

12. In our view, this is because the costs of fitting smoke filters are operating costs that relate to the future conduct of the business, ie the smoke filters relate to, and are required for, future operations.

Illustrative Example 7: staff training as a result of changes in the income tax system

13. IAS 37 (IE 7) gives another example of a government that introduces changes to the income tax system. As a result, an entity in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with financial services regulation. At the end of the reporting period, no retraining of staff has taken place. According to IE 7, there is no obligation because no obligating event has taken place.

14. We also observe that IAS 37 did not conclude that there is a constructive obligation to retrain the staff, even if some could argue that:

(a) it is economically unrealistic for the entity not to incur the expenditure if it has an intention of continuing in business;

(b) the entity has in certain cases created valid expectations on the part of staff or customers that the workforce will be retrained.

15. In our view, this is because the training costs are operating costs that relate to the future conduct of the business.

Illustrative Example 11: Repairs and maintenance

16. IAS 37 (IE 11) gives also two examples in connection with repairs and maintenance obligations. One example relates to a furnace with a lining that needs to be replaced every five years for technical reasons. At the end of the reporting period, the lining has been in use for three years. In the other example, an airline is required by law to overhaul its aircraft once every three years.

17. In both examples, no provision is recognised because there is no present obligation to incur the expenditures independently of the entity's future actions. The entity could, for example, stop operating the furnace, or sell the aircraft.

18. We note that it is economically unrealistic for the entity not to incur the expenditure if it has an intention of continuing in business. But that fact does not cause the recognition of a liability in this example, because repairs and maintenance costs are operating costs that relate to the future conduct of the business.

Requirements in IAS 37 regarding provision for restructuring

19. IAS 37 (paragraphs 80 and 81) states that:

> 80 A restructuring provision shall include only the direct expenditures arising from the restructuring, which are those that are both:
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> (a) necessarily entailed by the restructuring; and
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> (b) not associated with the ongoing activities of the entity.

> 81 A restructuring provision does not include such costs as:
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> (a) retraining or relocating continuing staff;
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> (b) marketing; or
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> (c) investment in new systems and distribution networks.
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> These expenditures relate to the future conduct of the business and are not liabilities for restructuring at the end of the reporting period. Such expenditures are recognised on the same basis as if they arose independently of a restructuring.

20. Consequently, even if there is a present obligation to restructure, the provision does not include costs that relate to the future conduct of the business.

Summary of the requirements and guidance provided in IAS 37

21. We observe that when an entity has an economic compulsion to incur operating costs that relate to the future conduct of the business, it does not create a constructive obligation and does not lead to the recognition of a liability in the Illustrative Examples described above.

22. Specifically, we observe that no constructive obligation exists for operating costs that relate to the future conduct of the business even if:

    (a) it is economically unrealistic for the entity to avoid the expenditure if it has the intention of continuing in business;

    (b) it would be necessary for an entity to take some unrealistic action to avoid the expenditure, such as to sell or stop operating tangible assets; or

    (c) there is a legal requirement to incur the expenditure if the entity has the intention of continuing in business.

Guidance in IFRIC 6

23. We think that IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* is consistent with the

rationale described above. The consensus reached in IFRIC 6 is that any obligations linked to participation in a market on a specified date do not give rise to liabilities until that date.

24. IFRIC 6 specifies the timing of recognition of liabilities for waste management charges imposed by a European Union directive. Specifically it addresses charges relating to waste electrical and electronic household equipment sold before 13 August 2005 ('historical household equipment'). The directive required member states to introduce legislation that:

    (a) charged the costs of disposing of historical household equipment to producers of that type of equipment that were in the market during a specified period (the measurement period) chosen by the member state;

    (b) required each producer to contribute in proportion to its share of the market in measurement period.

25. The IFRIC considered whether a producer's liability for the charge arose when the producer manufactured or sold equipment before 13 August 2005 or when it had market share during the (later) measurement period.

26. The Basis for Conclusions accompanying IFRIC 6 states that:

> 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. … 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 believe 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. …

Application to levies charged by a public authority

27. We think that a levy charged by a public authority is incurred as a result of operating in a specified period, ie an operating cost of the period in which it is triggered according to the legislation. For example, a levy charged for participation in a specific market is a cost that is incurred because the entity participates in the market in that specified period.

    In our view, an entity does not have a constructive obligation at a reporting date to pay a levy that arises from operating in a future period, even if the entity has an economic compulsion to operate in these future periods and there is a virtual certainty that it will do so. This is because this cost relates to the future conduct of the business and the entity could stop business in the market in which the levy is raised (even if it is economically unrealistic and if the intention of the entity is to continue in business).

Question for the Committee
Does the Committee agree that an entity does not have a constructive obligation to pay a levy that arises from operating in a future period, even if the entity is economically compelled to continue operating in that future period?

Does the going concern principle affect the timing of recognition of the liability?

28. This issue is related to but distinct from the previous issue regarding the existence of a constructive obligation, because it is a question about the fundamental basis of preparation of financial statements.

Guidance in the IFRS literature

29. Some question whether the going concern principle affects the timing of recognition of a liability. According to the *Conceptual Framework* (paragraph 4.1):

> The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations.

30. According to IAS 1 *Presentation of Financial Statements* (paragraph 25):

> When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

31. We note that IAS 1 sets out general features for the financial statements, including the accrual basis of accounting and the going concern principle. According to IAS 1 (paragraph 28):

> When the accrual basis of accounting is used, an entity recognises items as assets, liabilities, equity, income and expenses (the elements of financial statements) when they satisfy the definitions and recognition criteria for those elements in the framework.

32. We think that when an entity prepares financial statements on a going concern basis, it shall also comply with the accrual basis of accounting, ie with all the recognition and measurement provisions of IFRSs. Consequently, we think that the going concern principle cannot lead to the recognition of a liability that does not meet the definitions and recognition criteria set out in IAS 37. Specifically, we do not think that the going concern principle gives rise to a constructive obligation for costs that arise from operating in the future or that relate to the future conduct of its business. Paragraphs 18 and 19 in IAS 37 specify that no provision is recognised in these cases.

Guidance in IFRIC 6

33. We think that IFRIC 6 is consistent with the rationale described above. BC8 states that:

> 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.

Application to levies charged by a public authority

For levies charged by public authorities, we do not think that the going concern principle can lead to the recognition of a liability at a reporting date for levies that arise from operating in the future, ie levies that will be triggered in future periods according to the legislation. IAS 37 specifically states that no provision is recognised in that case.

Question for the Committee
Does the Committee agree that the going concern principle does not lead to the recognition of a liability at a reporting date for levies that arise from operating in the future?

Can there be multiple obligating events and if so, which one gives rise to the liability?

Guidance in IAS 37

34. According to IAS 37 (paragraph 10):

> An obligating event is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling the obligation.

35. We think that the main consequence of the definition above is that there can be only one single obligating event, which is the event that creates the present obligation in accordance with IAS 37. We acknowledge that for an obligating event to exist, it may in some circumstances require that other events have occurred previously. Nevertheless, we note that these previous events are necessary but not sufficient to create a present obligation. Consequently, we think that the liability is recognised when the last event in the series that is sufficient to create the present obligation has occurred.

36. But this does not imply that the liability is automatically recognised in full on a specified date. As explained below in the next section, we think that the liability may be recognised progressively in certain circumstances because the obligating event, ie the last event that creates the present obligation, occurs continuously over a specified period.

Guidance in IFRIC 6

37. We think that IFRIC 6 is consistent with the rationale described above. The consensus reached in IFRIC 6 is that any obligations linked to participation in a market on a specified date do not give rise to liabilities until that date. We note

that for the WE&EE obligation, the activity period and the calculation period coincides most of the time. But we also note that IFRIC 6 (BC7) addresses the issue of the date of recognition of a liability for a WE&EE obligation in the case where the calculation period precedes the activity period (as in the case of some of the levies considered in this paper). In the situation described in IFRIC 6, the WE&EE obligation exists only if the entity participates in the market both in the previous and the current period. In that case, IFRIC 6 concludes that the obligating event is still participation in the current period (ie the activity period, called measurement period in IFRIC 6), ie the last event in the series.

> Paragraph 9 **(emphasis added)**: 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.
>
> BC7: Some constituents asked the IFRIC to consider the effect of the following possible national legislation: the waste management costs for which a producer is responsible because of its participation in the market during a specified period (for example 20X6) are not based on the market share of the producer during that period but on the producer's participation in the market during a previous period (for example 20X5). The IFRIC noted that this affects only the measurement of the liability and that the obligating event is still participation in the market during 20X6.

Application to levies charged by a public authority

38. We note that some of the concerns expressed in the original submission are about the accounting treatment applicable to levies charged for participation in a specific market for which the calculation period precedes the activity period. For example, a levy charged for participation in a specific market is paid only if the entity has participated in the market in the current period and generated revenue in the previous period.

39. For these levies, we think that although participation in the market in previous periods may be necessary in order to establish a calculation basis for the levy, this is not sufficient to create a present obligation. We think that the obligating event is the event that triggers the payment of the levy as identified by the legislation, because this is the last of the necessary events to create the present obligation.

40. Consequently, for levies for which the calculation period precedes the activity period, we think that the obligating event is the participation in the market as identified by the legislation.

41. But this does not imply that the liability is automatically recognised in full on a specified date. As explained below in the next section, we think that the liability may be recognised progressively in certain circumstances because participation in the market as identified by the legislation occurs continuously over a specified period.

Question for the Committee
Does the Committee agree that a liability is recognised when the last of the necessary events to create the present obligation has occurred? Does the Committee agree that for levies charged for participation in a specific market, the obligating event is the participation in the market as identified by the legislation?

Does the recognition of a liability arise at a point in time or does it, in some circumstances, arise progressively over time?

Guidance in IAS 37

42. We note that most of the liabilities in IAS 37 and in the Illustrative Examples in IAS 37 are recognised at a point in time, ie at the date when the obligating event occurs. Nevertheless, we also note that there is one example in IAS 37 in which the liability is recognised progressively over time.

43. In Illustrative Example 3, an entity operates an offshore oilfield and is required to restore the seabed because of the damage that will be caused by extraction of the oil. According to this example, the restoration costs that arise through the extraction of oil are recognised as a liability when the oil is extracted. We understand that in this example, the damage is directly caused by the extraction of the oil, and that more damage occurs when more oil is extracted.

44. Thus, the outcome is that the liability for damage that is caused over time is recognised progressively over time as the entity extracts oil and causes that damage to the environment. But it is not clear whether this outcome is linked to a recognition issue or to a measurement issue.

45. Some argue that it is not a recognition issue but is instead a measurement issue. They note that the obligating event has already occurred (ie the initial damage caused by extraction of the oil) and that a liability should be recognised at that point in time for all of the damage incurred up to that point in time. They think that the only issue that remains is to measure the best estimate of the restoration costs that will be incurred to rectify the damage caused to date to the environment. In fact, according to the measurement provisions in IAS 37 (paragraph 36), the amount recognised as a liability is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. Thus, the progressive recognition of the liability over time is due to the fact that the restoration costs to be incurred rise over time as the entity extracts more oil and causes further damage to the environment.

46. Others think that this is a recognition issue, because the obligating event (ie the damage caused by extraction of the oil) occurs continuously over time. As stated in IAS 37 (paragraph 19), they think that a present obligation exists to the extent of the damage caused to date to the environment, because the entity has no present obligation to rectify the damage resulting from the extraction of the oil in the future (ie the future conduct of its business). In other words, a liability would be recognised progressively if the obligating event is linked to the entity's activity. They also note that the Illustrative Examples in IAS 37 (Appendix C *Examples: recognition*) deal with the recognition of the liability and with the identification of a present obligation as a result of a past obligating event and not with the measurement of the liability.

47. We think that both views may be argued. In any cases, both views have the same outcome even if the rationale is different. The liability is recognised for the damage caused to date. As a result, we think that a liability should be recognised progressively if:

    (a) the obligating event occurs continuously over time because it is linked to the entity's activity; and

    (b) the amount of the liability (ie the best estimate of the expenditure to incur at a reporting date) changes over time as a result of the entity's activity performed to date.

48. We think that the rationale explaining this outcome results from the following requirements in IAS 37:

    (a) an obligating event is an event that leaves the entity with no realistic alternative to settling an obligation (paragraph 10);

    (b) an obligation always involves another party to whom the obligation is owed (paragraph 20).

49. We think that if the two notions above are combined, it is possible in the circumstances described above to identify the obligating event as being the <u>activity</u> of the entity for which another party requires payment (or some other type

of performance) from the entity. We note that there are precedents for this view in other IFRSs:

(a) IAS 19 *Employee Benefits* requires an entity to recognise post-employment benefits when employees render their services, ie when the activity for which the employees receive the benefits occurs. An entity must recognise a liability at that time even if the benefits have not yet vested, ie even if the entity’s obligation to pay the benefits is conditional on future employment. The entity is viewed as having a liability even it could avoid the payment by terminating an employee’s contract during the vesting period.

(b) IFRS 2 *Share-based Payment* applies the same approach for cash-settled share-based payments. It requires an entity to recognise a liability when it receives the services for which it has granted the payments, even if at that time the other party’s right to receive the payment is subject to vesting conditions that are within the control of the entity.

Question for the Committee
Does the Committee agree that a liability should be recognised progressively if the obligating event occurs continuously over time and the amount of the liability changes over time as a result of the entity’s activity performed to date? Does the Committee think that other factors should be considered in order to recognise a liability progressively?

Application to levies charged by a public authority

50. For levies charged for participation in a specific market, this would imply that a liability is recognised progressively if:

(a) participation in the market as identified by the legislation occurs continuously; and

(b) the amount of the levy changes as a result of the entity’s activity performed to date.

51. We think that there are no inconsistencies between the consensus in IFRIC 6 and this analysis. In both cases, the obligating event is participation in the market as identified by the legislation. But in some circumstances, we think the terms of the legislation provide evidence that participation in the market occurs continuously over a specified period.

52. For example, we think that the liability is recognised progressively if the levy is determined by reference to revenues generated in the market in the current period (see Example 1 below). In that case, we think that participation in the market occurs continuously as the entity generates revenues in the market.

53. If participation in the market occurs on a relative specified date such as the end of the reporting period and the levy payable is proportionate to the length of the entity's accounting period, we think that there are two views (see Example 2 below):

    (a) View A: the liability is recognised at a point in time because participation in the market occurs on the last day of the annual reporting period.

    (b) View B: the liability is recognised progressively because the terms of the legislation provide evidence that participation in the market occurs continuously over the reporting period. As mentioned in paragraphs 48 and 49, proponents of view B think that it is possible in these circumstances to identify the obligating event as the continuing participation of the entity in the market for which the public authority requires payment from the entity (not participation in the market at the end of the entity's accounting period). This is because of the interaction of the use of a relative date and the adjustment of the amount payable pro-rata to the length of the accounting period. In other words, proponents of view B think that an entity should apply the requirements of IAS 37 at an interim reporting date as if it was an annual reporting date, ie as if participation in the market had occurred on the last day of each interim reporting period.

54. If participation in the market occurs on an absolute specified date (see Example 3 and 4 below), we think that the liability should be recognised at a point in time on the absolute specified date identified by the legislation.

Example 1: the amount of the levy is determined by reference to revenues generated by the entity in the market in the current period

> Example 1: A levy is due if Entity A generates revenues in a specific market in 20X1 and the amount of the levy is determined by reference to revenues generated by Entity A in the market in 20X1. Entity A generates revenues in the market on 1 January 20X1.
>
> In this example, we think that the liability is recognised progressively as the entity generates revenue over the year 20X1. The obligating event is the generation of revenues on 1 January 20X1 and the amount of the liability is based on the entity's revenues generated in 20X1. Before generating any revenues in the specific market in 20X1, Entity A has no obligation. At 30 June 20X1, Entity A has an obligation to pay the levy to the extent of the revenues generated in the specific market for 1 January to 30 June 20X1.

Example 2: participation in the market occurs on a relative specified date and the levy payable is proportionate to the length of the entity's accounting period

> Example 2: A levy is due if Entity B participates in a specific market on the last day of the annual reporting period and the amount of the levy payable is proportionate to the length of Entity B's accounting period if the reporting period is shorter than 12 months. The amount of the levy is determined by reference to data in the balance sheet of Entity B on the last day of the reporting period. Entity B is a calendar year-end entity and the last day of the reporting period is 31 December 20X1.
>
> View A: Proponents of view A think that the liability is recognised at a point in time on the last day of the annual reporting period, ie 31 December 20X1. They do not think that the obligating event has occurred before that date, because the assumption is that the accounting period is a 12-month period and in that case, participation in the market occurs on the last day of the accounting period.
>
> View B: Proponents of view B think that the terms in the legislation described above provide evidence that the obligating event is continuing participation in the market over the reporting period, ie over 20X1. This is because of the interaction of the use of a relative date and the adjustment of the amount payable pro-rata to the length of the accounting period. Consequently, they think that the liability is recognised progressively over 20X1 proportionately to the length of the time elapsed at the reporting date.

Example 3: participation in the market occurs on an absolute specified date, eg 31 December 20X1

> Example 3: A levy is due if Entity C participates in a specific market on 31 December 20X1. The amount of the levy is determined by reference to data in the balance sheet of Entity C on 31 December 20X1.
>
> In this example, we think that the liability is recognised at a point in time on the date the event that triggers the payment of the levy as identified by the legislation occurs, ie on 31 December 20X1.
>
> The fact that in the legislation the amount of the levy is affected by the length of entity's C accounting period does not change this conclusion. In fact, in that example, arguments developed in view B in paragraph 53 do not apply, because at a reporting date that occurs before 31 December 20X1, participation in the market has not occurred, the date being an absolute specified date.

Example 4: participation in the market occurs on an absolute specified date, eg 1 January 20X1 and calculation period precedes activity period

> Example 4: A levy is due if Entity D generates revenues in a specific market in 20X1 and the amount of the levy is determined by reference to revenues generated by Entity D in the market in 20X0. Entity B starts to generate revenues in the market on 1 January 20X1. The amount of the levy is not affected by the length of entity's D accounting period.
>
> In this example, we think that the liability is recognised at a point in time on the date the event that triggers the payment of the levy as identified by the legislation occurs, ie on 1 January 20X1. Before generating any revenues in the market in 20X1, Entity D has no obligation. If Entity D generates revenues on 1 January 20X1 but ceases to operate in the market on 2 January 20X1, it will still have to pay the full amount of the levy (ie at that date the amount of the levy does not depend anymore on the entity's future conduct of its business).

Questions for the Committee

Does the Committee agree that a liability for the obligation to pay a levy is recognised progressively if participation in the market occurs continuously?

> Does the Committee think that participation in the market occurs continuously in the following situations:
>
> (a) the levy is determined by reference to revenues generated in the market in the current period (Example 1)?
>
> (b) participation in the market occurs on a relative specified date and the levy payable is proportionate to the length of the entity's accounting period (Example 2)?
>
> Does the Committee agree that a liability is recognised at a point in time in Example 3 and 4 above?

Should a liability to pay a levy charged for participation in a specific market be recognised when the entity is required to participate in that specific market in the future period(s)?

55. In some circumstances, an entity is required to participate in a specific market for a minimum specified period because of the regulation applicable to that market. For example, a railway entity is granted by the public authority a right to operate a specific line for a period of five years. According to the regulation, the entity cannot withdraw from that market during this period, unless it notifies the public authority two years in advance. If a public authority charges an annual levy for entities participating in the railway market, some could argue that, as soon as the entity signs the contract with the public authority, it has a present obligation to pay the levies triggered in the next two years. We think that there are two views on this issue.

View C: no liability should be recognised for levies triggered in future periods

56. Proponents of view C think that levies are costs incurred as a result of operating in a specified period, ie operating costs of the period in which they are triggered according to the legislation. Consequently, no provision should be recognised for levies triggered in a future period, ie levies that relate to the future conduct of the business, even if there is a requirement to participate in the market in the future.

Moreover, proponents of view C also think that the liability should be recognised progressively as the entity performs its activity in some circumstances (see above). Proponents of view C note that a restructuring provision does not include costs that relate to the future conduct of the business, ie future operating costs, even if there is a present obligation to restructure. Costs such as retraining or relocating continuing staff or marketing are recognised on the same basis as if they arose independently of a restructuring (IAS 37 paragraph 80 and 81).

View D: a liability should be recognised for levies triggered in future periods

57. Proponents of View D think that, as soon as the entity signs the contract with the public authority (or as soon as the entity starts operating the line), a liability should be fully recognised for the best estimate of the levies to be paid in the next two years. They think that the entity has an indirect present obligation to incur the levies in the next two years because the entity is required to participate in the market in the next two years. They also think that in this specific case, an asset (ie a right to operate the railway line for the next two years) may have to be recognised as soon as the entity signs the contract with the public authority (or as soon as the entity starts operating in the market) and that the recognition of the asset triggers the recognition of the liability. Paper 2B discusses whether the debit side of the liability is an asset or an expense.

58. The staff favours view C because of the arguments mentioned above.

Question for the Committee
Does the Committee agree that no provision should be recognised for levies triggered in future periods, even if the entity is required to participate in the market in future periods?