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Project **Levies charged for participation in a market on a specified date**

Topic **Illustrative examples**

Purpose of the paper

1. We present below illustrative examples that aim to provide some guidance on the accounting treatment applicable to a range of levies charged for participation in a market on a specified date.

2. For the purposes of these examples, the entities' annual reporting date is 31 December. We note that some legislation impose an annual levy for each financial reporting period, but for simplicity reasons, all the levies in the examples below are payable in a given calendar year.

Illustrative example 1: calculation period and activity period coincide and the amount of the levy is determined by reference to revenues

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

4. IAS 37 (Illustrative example 3, offshore oilfield) specifies that an obligation may arise progressively. In that case, the provision is accrued as the obligation arises.

5. We think that in this example, the obligating event that creates a present obligation to pay the levy arises progressively as entity A generates revenues in the market. Prior to generating any revenues in the specific market in 2011, entity A has no obligation.

6. If entity A stops to operate in the market and therefore ceases to generate revenues, it will not have an obligation to pay any additional levy. Entity A has an obligation to pay the levy only to the extent that it has already generated revenues in the specific market in 2011.

7. Consequently, in that case, the liability is accrued over the year 2011. The debit side of the liability is an expense.

Illustrative example 2: calculation date is at the end of the activity period and the amount of the levy is determined by reference to balance sheet data

8. The legislation imposes an annual levy for each calendar year for entities participating in a specific market. A levy is due if entity B participates in that specific market in 2011. The amount of the levy is determined by reference to balance sheet data of entity B on 31 December 2011. The levy is payable in April 2012. Entity B participates in the market on 1 January 2011. In this example, calculation date (ie 31 December 2011) is at the end of the activity period (ie 2011).

9. In this example, we think that the obligating event that creates the present obligation to pay the levy arises on 1 January 2011 by entity B participating in the market on that date. At that date, we think that entity B has a present obligation to pay the levy because:

   (a) it benefits from the right to participate in the market,

   (b) and the obligation to pay the levy exists independently of entity B's future actions (the calculation basis of the levy is established because it is determined by reference to balance sheet data).

10. In particular, we think that if the only way for entity B to avoid the expenditure is to liquidate or curtail materially the scale of its operations, a provision should be recognised to the extent that entity B benefits from the right to participate in the market. 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'.

11. In other words, we think that under the going principle concern, a provision should be recognised on the date the entity starts to benefit from the right to participate in the market if the payment of the levy is independent of entity B's future actions. We think that this is the case when the amount of the levy is determined by reference to balance sheet data. The fact that the levy is charged only at the end of the year on the basis of the balance sheet data at that date does not modify this analysis. This affects only the measurement of the liability.

12. We think that this case is different from the case where the obligation is dependant of the entity's future actions (for example the entity needs to generate revenues to fall in the scope of the levy). In the example above, even if entity B does not generate any revenues in the market or stops doing business on 2 January 2011, it has still an obligation to pay the levy.

13. Consequently, the liability should be recognised in full on 1 January 2011. The debit side of the liability is an asset to the extent that the right to operate in the market meets the definition of an intangible asset. This is because entity B has a right to continue to participate in the market throughout 2011 without additional charges arising from that continued activity. This asset is amortised over the year 2011.

Illustrative example 3: calculation period precedes activity period and the entity has no legal obligation at the end of the calculation period to participate in the market in the future periods

14. The legislation imposes an annual levy for each calendar year for entities participating in a specific market. The levy is due if entity C generates revenues in that specific market in 2011. The amount of the levy is determined by reference to revenues generated by entity C 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 C participates in the specific market on 1 January 2011. In this example, the calculation period (ie 2010) precedes the activity period (ie 2011).

15. The liability for the obligation to pay the levy arising from the activity in the specific market in 2011 should be recognised in full on 1 January 2011. In fact, at that date, entity C:

    (a) benefits from the right to participate in the market in 2011, and ;

    (b) has a present obligation to pay the levy arising from the activity in the specific market in 2011 (the calculation basis of the levy is established). Even if the entity stops to participate in the market on 2 January 2011, the levy will be payable in full.

16. In our view, entity C has no constructive obligation to pay the levy at the end of the year 2010 because it could avoid the expenditure by its future actions. It could stop to participate in the market and, in that case, no revenue would be recognised in 2011 and entity C would not fall in the scope of the levy.

17. Consequently, the liability for the obligation to pay the levy arising from the activity in the specific market in 2011 should be recognised in full on 1 January 2011. The debit side of the liability is an asset to the extent that the right to participate in the market meets the definition of an intangible asset. This is because entity C has the right to continue to participate in the market throughout 2011 without additional charges arising from that continued activity. The asset is amortised over the year 2011.

18. If a minimum amount of revenue has to be reached in 2011 in order to fall within the scope of the levy, we believe the obligating event is the achievement of the minimum level. In fact, in our view, it is only at that date that the entity has a present obligation to pay the levy.

Illustrative example 4: calculation period and activity period coincide and the entity has a legal obligation to participate in the market in the future periods prior to the activity period

The amount of the levy is determined by reference to revenues

19. Entity D is granted by the public authority a right to operate in a specific market for a period of 5 calendar years starting on 1 January 2011. According to the regulation, entity D cannot withdraw from that market during this period of 5 years, unless it notifies the public authority 2 years in advance.

20. The legislation imposes an annual levy for each calendar year for entities participating in that specific market. The levy is due if entity D generates revenues in that specific market in 2011. The amount of the first annual levy is determined by reference to revenues generated by entity D in the market in 2011. The levy arising from the activity in the market in 2011 is payable in full in April 2012. Entity D generates revenues in the specific market on 1 January 2011. In this example, the activity period (ie 2011) and the calculation period (ie 2011) are the same.

21. At year-end 2011, the entity has a legal obligation to participate in the market in 2012 and 2013. The entity cannot withdraw from the market for the next 2 years because of the regulation. The entity has no legal obligation to participate in the market in 2014 and 2015 because it can still notify the public authority that it wants to withdraw from the market for this future period.

22. In this example, we think that:

    (a) Entity D benefits from a right to participate on the market for 5 years starting on 1 January 2011;

    (b) The obligating event that creates a present obligation to pay the first annual levy arises progressively as entity D generates revenues in the market in 2011.

23. Consequently, the liability for the obligation to pay the levy is accrued over the year 2011. At year-end 2011, the liability is recognised in full. The debit side of the liability is an expense.

24. No liability should be recognised for the 2012 levy, or later levies, at year end 2011. At that date, entity D has no present obligation to pay the levies arising from the activity in the market in 2012 and later because it has not yet generated the revenues used as a calculation basis for these levies (ie this obligation is dependent of entity D’s future conduct of its business).

The amount of the levy is fixed or is determined by reference to balance sheet data

25. The accounting treatment could be different if the amount of the levy is determined independently of the entity’s future conduct of its business. For example, the fact pattern is the same as above but:

(a) The levy is due if entity E participates in that specific market on 31 December 2011 and the amount of the levy is fixed,

(b) Or the levy is due if entity E reports balance sheet data on 31 December 2011 and the amount of the levy is determined by reference to these balance sheet data.

26. We note that 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'.

27. In that case, we think that there are two different views.

View A:

28. At year-end 2011, some could argue that a liability should be recognised for the obligation to pay the levies arising from the activity in the market in 2011, 2012 and 2013 (ie the non-cancellable levies). At that date, entity E benefits from a right to participate on the market for 5 years starting on 1 January 2011 and it has a present obligation to pay these levies because:

(a) the obligation to pay these levies is independent of its future actions (it does not depend from the future conduct of its business),

(b) the assumption is that entity E will continue in operations in the future periods according to the going concern principle and will participate in the market in 2012 and 2013 because of the regulation (see also illustrative example 2).

29. This accounting treatment is consistent with the provisions in IAS 17 regarding finance leases. Entity E should estimate the non-cancellable levies payable in 2012 and 2013. The debit side of the liability for the obligation to pay the levies arising from the activity in the market in 2012 and in 2013 is an asset to the extent that the right to operate in the market meets the definition of an intangible asset. This is because entity E has a right to continue to participate in the market throughout 2012 and 2013 without additional charges arising from that continued activity. The asset is amortised over the years 2012 and 2013.

View B:

30. At year-end 2011, no liability should be recognised for the 2012 levy, or later levies. Entity E does not benefit from a right to participate on the market for 5 years starting on 1 January 2011 but only from an annual right each year for 5 years. In that case, the contract is still executory for the 2012- 2015 periods and the levies associated are operating costs that need to be incurred in future specified periods.