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22 August 2012

Dear Francoise

EFRAG's draft Comment Letter on the Draft IFRIC Interpretation "Levies Charged by Public Authorities on Entities that Operate in a Specific Market"

I am writing on behalf of the UK's Financial Reporting Council (FRC) in response to EFRAG's draft comment letter on the draft IFRIC Interpretation "Levies Charged by Public Authorities on Entities that Operate in a Specific Market".

The FRC has also responded to the IASB and a copy of the response is attached.

As you will notice from the attached response to the IASB, the FRC does not agree with the EFRAG view that the consensus in the draft IFRIC interpretation will lead to decision useful information for users of financial statements. In particular, accounting for balance sheet based levies (e.g. UK bank levy) in accordance with this draft Interpretation will lead to counter-intuitive information presented to users at the interim date. The FRC is concerned that accounting and reporting that diverges so significantly from the underlying substance of the transaction has the potential for bringing accounting into disrepute. As a result, we recommend that rather than issuing this IFRIC in final form the underlying principle in IAS 37 should be referred to the IASB for review.

We do not have any comments on the scope of the interpretation and not identified any other levies that should be within the scope of this interpretation.

Should you have any queries please do not hesitate to contact me or Seema Jamil-O'Neill on s.jamiloneill@frc.org.uk.

Yours sincerely

Roger Marshall

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22 August 2012

Dear Sir

Draft IFRIC Interpretation "Levies Charged by Public Authorities on Entities that Operate in a Specific Market"

I am writing on behalf of the UK's Financial Reporting Council (FRC) in response to the draft IFRIC Interpretation "Levies Charged by Public Authorities on Entities that Operate in a Specific Market".

The FRC agrees that there is some divergence in practice in how entities account for an obligation to pay levies charged by public authorities. Therefore, guidance in this instance has the potential for in achieving consistency in accounting. However, we are concerned that:

(a) Although the IFRIC consensus is a technically correct analysis of how IAS 37 should be applied to levies, in our view the resulting Interpretation does not lead to decision useful information for users of financial statements. Users of financial statements expect entities to comply with IAS 1 "Presentation of Financial Statements" which requires that "financial statements should present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework." (IAS 1.15) Whilst it is possible to justify the Interpretation technically it does not result in the substance of the transaction being reported; for example it is difficult to justify that non-recognition of the UK bank levy as a liability in the interim financial statements is a faithful representation of its substance. In arriving at the accounting for such levies, users believe that the economic compulsion to continue to operate in a future period and the legal requirement to incur the levy if the entity does continue in business constitute sufficient grounds for concluding that a constructive obligation to pay the levy exists. However, even ignoring economic compulsion, it cannot be ignored that the liabilities at the interim are likely to be taxed at the year end.

(b) The requirements in IAS 37 "Provisions, Contingent Liabilities and Contingent Assets" form the basis of the conclusions in this draft Interpretation and in IFRIC 6 "Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment" lead to conclusions that do not reflect the substance of the underlying transaction. This indicates to us that either there is a fundamental inconsistency between the requirements in IAS 1 and those in IAS 37 or the underlying principle in IAS 37 is wrong.

We are concerned that accounting and reporting that diverges so significantly from the underlying substance of the transaction has the potential for bringing accounting into disrepute. As a result, we would recommend that rather than issuing this IFRIC in final form the underlying principle in IAS 37 should be referred to the IASB for review.

Yours sincerely

Roger Marshall

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Appendix A: Responses to questions in the draft Interpretation

Question 1—Scope

The draft Interpretation addresses the accounting for levies that are recognised in accordance with the definition of a liability provided in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Levies that are within the scope of the draft Interpretation are described in paragraphs 3–5.

Do you agree with the scope proposed in the draft Interpretation? If not, what do you propose and why?

1. We have not identified any UK levies that would be outside the scope of this draft Interpretation.

Question 2—Consensus

The consensus in the draft Interpretation (paragraphs 7–12) provides guidance on the recognition of a liability to pay a levy.

Do you agree with the consensus proposed in the draft Interpretation? If not, why and what alternative do you propose?

2. We do not believe that the consensus in this draft Interpretation always leads to decision useful information for users. Below we use the example of the UK Bank levy to explain our conclusion. Details of the Levy are included in Appendix B of this letter.

3. The consensus and basis for conclusions is in line with the consensus in IFRIC 6. It is based on the assumption that the obligating event for the UK bank levy is the year-end balance sheet liability and equity. This is contrasted with a revenue based levy where the obligating event is considered to be the generation of the revenue during the period. However, this ignores the fact that revenue generation and asset /liability creation are interrelated and that one cannot exist without the other. The distinction appears false when considered in this light.

4. It should also be noted that the substance of the UK bank levy is that it relates to the year at the end of which it is measured. These are not the costs that must be incurred to operate in the future but instead relate to its operation during the year. This is also evidenced by the quarterly instalments required to be made by the banks during the year, in advance of the final measurement of the liability based on the year-end financial position.

5. If the consensus in the draft IFRIC Interpretation was applied to the UK Bank Levy, we believe that the part payments under the quarterly instalment system during the year would lead to a prepayment asset being accrued until the liability crystallises at the year end. As a result, at the half year (or other interim date) there will be an asset on the balance sheet (for the prepayment amount in relation to the bank levy) which will switch to an expense at the year-end without the bank doing anything different.

6. Although technically correct, the draft IFRIC consensus does not lead to decision-useful information at the interim reporting date. The IASB often asserts that disclosure should not be an alternative to good accounting. However, in this instance disclosure is the only

means by which a bank can clarify carrying a prepayment for the bank levy at the half year and the year end.

Disclosures

7. The draft Interpretation is silent on disclosures at the interim reporting period. In the absence of any direction to provide disclosure in the draft Interpretation, we take the view that the guidance in IAS 37 “Provisions, Contingent Liabilities and Contingent Assets” on disclosures would be applied. Table 1 below is the reproduction of the table in Appendix A to IAS 37 which summarises the main requirements in relation to provisions and contingent liabilities.

Table 1: Provisions and Contingent Liabilities

Where, as a result of past events, there may be an outflow of resources embodying future economic benefits in settlement of: (a) a present obligation; or (b) a possible obligation whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.		
There is a present obligation that probably requires an outflow of resources.	**There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.**	**There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.**
The provision is recognised (paragraph 14)	No provision is recognised (paragraph 27)	No provision is recognised (paragraph 27)
Disclosures are required for the provision (paragraph 84 and 85)	Disclosures are required for the contingent liability (paragraph 86)	No disclosure is required (paragraph 86)

8. On the basis of the consensus in the draft Interpretation we believe that reporters at the interim stage will follow the middle column and disclose the contingent liability in accordance with paragraph 86 of IAS 37. That paragraph requires disclosure of a brief description of the nature of the contingent liability, accompanied by an estimate of its financial effect, an indication of the uncertainties relating to the amount or timing of any outflow and the possibility of any reimbursement. Under the bank levy, given the part payments, there may already have been outflows that would make the estimation of the full year amount easier to identify and link with the information in the cash flow statement.

Alternative

9. We are concerned that accounting and reporting that diverges so significantly from the underlying substance of the transaction has the potential for bringing accounting into disrepute. As a result, we would recommend that rather than issuing this IFRIC in final form the underlying principle in IAS 37 should be referred to the IASB for review.

Question 3—Transition

Entities would be required to apply the draft Interpretation retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Do you agree with the proposed transition requirements? If not, what do you propose and why?

10. We agree with the proposed transition requirements. We believe that retrospective application is consistent with the requirements in IAS 8. Furthermore, we have no evidence that there are cost benefit implications necessitating any transitional provisions.

Appendix B: Details of the UK Bank Levy

Bank Levies were announced by the UK Government and enacted in legislation during Q3 2011.

The liability under the UK Bank Levy is assessed using the global consolidated balance sheet (chargeable equity and liabilities above £20 billion) for UK Banks and banking group.

Non-UK banks will be charged in respect of their chargeable equity and liabilities in relation to their UK operations only. The legislation includes a targeted anti-avoidance rule aimed at arrangements entered into with the purpose of reducing/ eliminating liability to the levy.

Banks pay this levy partly in advance through the quarterly instalment payments system based on an estimate of the year end position with a final payment/ repayment made based on the year-end chargeable equity and liabilities.