IFRS Foundation

2023

World Standard-setters Conference

#WSS2023

Better information for better decisions

Provisions—Targeted Improvements to IAS 37

Breakout session 5

IFRS Accounting

Presenters

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Agenda

1. Project overview
2. Amending and clarifying requirements for a present obligation
3. Implications—illustrative examples
4. Open question—thresholds

Project overview

Project status and timeline

2018

- ***Conceptual Framework* issued**

Now

- **IASB developing proposals for amending IAS 37**

Potentially 2024

- **Exposure Draft published**

Potentially 2025

- **proposals redeliberated**
- **amendments issued**

Project scope—three targeted improvements

1. Recognition: amend and clarify requirements for a present obligation—applying revised *Conceptual Framework*.
2. Measurement: specify discount rate more precisely—whether to include or exclude own credit risk.
3. Measurement: specify that costs of settling a provision include both incremental costs and an allocation of other directly related costs.

Amending and clarifying requirements for a present obligation

IAS 37 recognition criteria

❶ The entity has a present obligation as a result of a past event,

❷ outflows are probable, and

❸ the amount can be reliably estimated.

Possible amendments would affect this criterion

Present obligation criterion—existing requirements

IAS 37.19
Obligation must exist independently of entity's future actions.

IAS 37.10
Obligating event = event that creates an obligation entity has no realistic alternative to settling.

?

1. No present obligation if entity can avoid future expenditure through its future actions.

2. IFRIC 21 *Levies*—obligating event is activity that triggers payment.

Problems

1. Contradictory guidance—what if action require to avoid future expenditure is unrealistic?
2. IFRIC 21 → late and point-in-time recognition of annual levies, inconsistent with other IFRS Accounting Standards.

Present obligation criterion—possible new requirements

Apply concepts added to *Conceptual Framework* in 2018

Disentangle and separately explain three conditions:

1. **STRENGTH CONDITION**—entity has an obligation—a responsibility it has no practical ability to avoid
2. **NATURE CONDITION**—obligation is to transfer an economic resource
3. **TIMING CONDITION—**obligation is a *present* obligation as a result of past events.

Clearer requirements, promoting consistent application

Redefine 'as a result of past events' withdrawing IFRIC 21 *Levies*

Earlier and progressive recognition of some levies

Applying the present obligation criterion—**Step 1**

Is the strength condition met?

Does a specified action (or combination of actions) of the entity give it a responsibility it has **no practical ability to avoid**?

No

No liability—no provision recognised

Yes

Step 2

Responsibility could be:

- **legal**—ie derive from legislation, a contract or other operation of law; or
- **constructive**—ie derive from entity's past practice, published policies or sufficiently specific current statement.

Applying the present obligation criterion—**Step 2**

Is the nature condition met?

Does the obligation have the potential to require the entity to **transfer an economic resource**?

No

No liability—no provision recognised

Yes

Step 3

An obligation to **exchange** economic resources is not an obligation to transfer an economic resource unless the exchange is unfavourable—eg an onerous contract.

Applying the present obligation criterion—**Step 3**

Is the timing condition met?

Has the entity taken the specified action before the end of the reporting period?

If the obligation arises from a combination of actions, has the entity:

a) taken any of the actions; and
b) no practical ability to avoid the remaining actions?

No

No liability—no provision recognised

Yes

✓ **Present obligation criterion satisfied**

Provision recognised if two other criteria are also satisfied.

If…

✓ outflows are probable

✓ amount can be reliably estimated

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Implications—illustrative examples

Example 1—Levy

- Legislation requires energy companies operating on 1 January 2024 to pay a levy.
- Each company must pay 1% of revenue it generated in 2023.
- An energy company is preparing financial statements for the year ended 31 December 2023.

Is the present obligation criterion satisfied at 31 December 2023? ✓

Conditions		
1 **Strength**	No practical ability to avoid?	✓
2 **Nature**	Transfer an economic resource?	✓
3 **Timing**	Entity has taken one of the specified actions?	✓
	And has no practical ability to avoid remaining specified actions?	✓

Example 2—Net zero commitment

In 2023, a company announces its commitment to become ‘net zero’ by 2030. It announces it will:

a) immediately start changing its processes, aiming to reduce its annual CO_2 emissions by 60% by 2030; and

b) in 2030 and thereafter, offset its remaining annual emissions by paying for trees to be planted.

Is the present obligation criterion satisfied at 31 December 2023? ✗

<table>
<tr><th colspan="2">Conditions</th><th>(a)</th><th>(b)</th></tr>
<tr><td>1 Strength</td><td>No practical ability to avoid?</td><td colspan="2">✓ If announcement creates a valid expectation that the entity will fulfil its commitment</td></tr>
<tr><td>2 Nature</td><td>Transfer an economic resource?</td><td>✗</td><td>✓</td></tr>
<tr><td>3 Timing</td><td>Entity has taken the specified action?</td><td></td><td>✗</td></tr>
</table>

Example 3—Restructuring plan

A company's employees are contractually entitled to compensation if the company terminates their contracts.

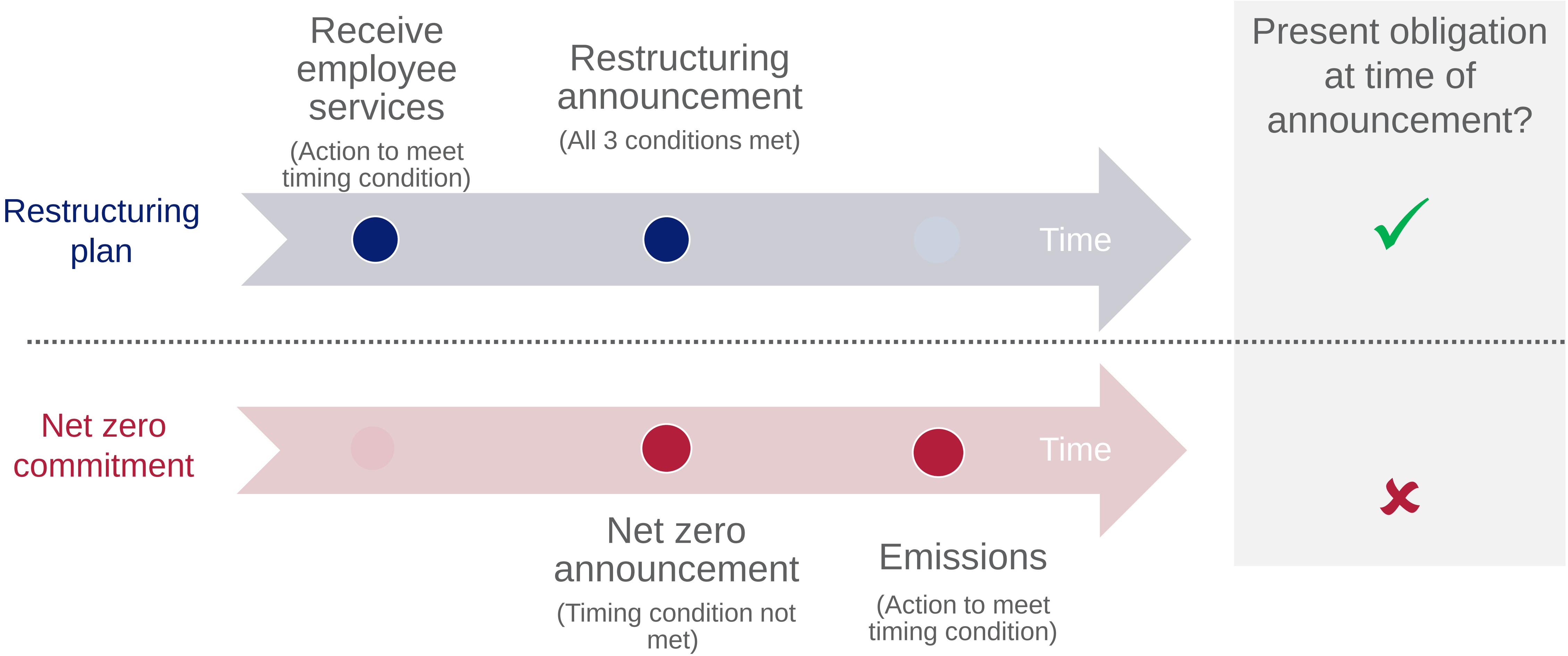
During 2023, the company has:

- prepared a detailed formal plan for closing a division, terminating that division's employees' contracts; and
- announced the main features of the plan to employees and others affected.

Is the present obligation criterion satisfied at 31 December 2023? ✓

Conditions			
1 **Strength**	No practical ability to avoid?	✓
2 **Nature**	Transfer an economic resource?	✓
3 **Timing**	Entity has taken one of the specified actions?	✓
	And has no practical ability to avoid remaining specified actions?	✓

Comparison: net zero commitment (Example 2) versus restructuring plan (Example 3)



Open question—thresholds

Charges triggered when a measure of activity exceeds a threshold

Examples

- Sector levies on entities with revenue above a specified amount.
- Penalties for CO_2 emissions above an allocated quota.
- Payments to return a leased asset in a below-spec condition.

Thresholds could be cumulative or average measures.

Need for application requirements?

- Prevalence—widespread in practice?
- Materiality?
- Risk of diverse interpretations of general requirements?

Application requirements for obligations triggered by exceeding a threshold

Possible views on when timing condition is met

View A

'Specified action' is activity above threshold.

No present obligation until activity has exceeded threshold.

Provision recognised later

View B

'Specified action' is activity to which charge applies.

Present obligation accumulates from when entity starts activity:

A. if entity has no practical ability to avoid exceeding threshold; **or**

B. irrespective of entity's ability to avoid exceeding threshold—exceeding threshold is not a separate activity.

- Provision recognised earlier
- Expected outcome reflected in measurement—portion of total expected charge allocated to activity to date

Charges triggered by exceeding a threshold—example

A government charges a levy on airlines whose revenue exceeds CU50 million in a calendar year. The levy is 2% of revenue above CU50 million.

An airline is preparing interim financial statements for the 6 months to 30 June 2023.

Revenue in the 6 months to 30 June 2023 is CU44 million. Management forecasts that revenue for the full year will be CU100 million.

Is the present obligation criterion satisfied at 30 June 2023?

Step 3

Is the timing condition met?

Has the entity taken the specified action by 30 June?

If the obligation arises from a combination of actions, has the entity:

a) taken any of the actions; and
b) no practical ability to avoid the remaining actions?

Questions and comments

Further information

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Further information

Agenda papers for IASB’s April 2023 meeting

Agenda Paper 22 *Liability definition and ‘present obligation’ recognition criterion*

Agenda Paper 22 (Appendix A) *Initial staff suggestions for amendments to IAS 37*

Agenda Paper 22 (Appendix B) *Initial staff suggestions for amendments to illustrative examples accompanying IAS 37*

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