IFRS

STAFF PAPER

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IASB® Meeting

Project	**Provisions**
Paper topic	Project proposal

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Purpose of session

1. The purpose of this session is to decide whether the International Accounting Standards Board (Board) should add to its standard-setting programme a project to amend aspects of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and, if so, what the scope of that project should be.

Criteria for adding a project to the standard-setting programme

2. Paragraphs 5.4–5.8 of the IFRS Foundation *Due Process Handbook* discuss criteria for adding a project to develop a new IFRS Standard or make major amendments to an existing IFRS Standard.

Merits of adding a potential project

3. Paragraph 5.4 states that the Board evaluates the merits of adding a potential project primarily on the basis of the needs of users of financial reports, while also taking into account the costs of preparing the information in financial reports. When deciding whether a potential project will address users' needs, the Board considers:

   (a) whether there is a deficiency in the way particular types of transactions or activities are reported in financial reports;

(b) the importance of the matter to those who use financial reports;

(c) the types of entities likely to be affected by any proposals, including whether the matter is more prevalent in some jurisdictions than others; and

(d) how pervasive or acute a particular financial reporting issue is likely to be for entities.

4. Paragraph 5.7 adds that the Board should add a project only if it considers that the benefits of the improvements to financial reporting will outweigh the costs.

Consultation

5. Paragraph 5.5 states that the Board considers adding a project after considering any research it has undertaken on the topic. It adds that the Board would normally put together a proposal for a project only after it has published a discussion paper and considered the comments it received from that consultation. It notes that publishing a discussion paper before adding a standard-setting project is not a requirement, but the Board must be satisfied it has sufficient information and understands the problem and the potential solutions well enough to proceed without one.

6. Paragraph 5.6 states that before reaching a decision, the Board consults the IFRS Advisory Council, Accounting Standards Advisory Forum (ASAF) and accounting standard-setting bodies.

Merits of adding a project to amend aspects of IAS 37

7. Stakeholders have suggested various aspects of IAS 37 are deficient and need to be amended.

8. The Board already has on its workplan a project to make one narrow-scope amendment to IAS 3—to clarify which costs an entity includes in assessing whether a contract is onerous.[1]

[1] IASB Implementation project Onerous Contracts—Cost of Fulfilling a Contract.

9. Our research in the Provisions project has involved gathering evidence about other aspects of IAS 37 that stakeholders have suggested are deficient.

10. Our aim has been to gather the evidence needed to decide whether, for each aspect:

    (a) amending IAS 37 would address the needs of users of financial reports (applying the criteria in paragraph 5.4 of the *Due Process Handbook*); and

    (b) the benefits of the improvements to financial reporting would outweigh the costs.

    Agenda Paper 22A *Provisions—Research Summary* summarises the evidence gathered.

11. On the basis of this evidence, the staff conclude that a project to make three targeted improvements to IAS 37 would meet the criteria in the *Due Process Handbook*. Those aspects, and the sections of the research summary (Agenda Paper 22A) in which the staff conclusions are explained are:

Table 1
Possible amendments staff think meet *Due Process Handbook* criteria

	Aspect of IAS 37	Possible improvement	Research summary reference
1	Liability definition and requirements for identifying liabilities	Align definition and requirements with definition and concepts in *Conceptual Framework for Financial Reporting (Conceptual Framework).* Could include withdrawing IFRIC 21 *Levies*.	Section 1
2	Requirements for measuring provisions—costs to include.	Clarify which costs to include.	Section 3, paragraphs 3.16 – 3.21
3	Requirements for measuring provisions—discount rates.	Clarify whether rate at which an entity discounts provisions for the time value of money should reflect the entity's own credit risk.	Section 3, paragraphs 3.22 – 3.28

12. The staff conclude that amending some other aspects of IAS 37 would not meet the criteria. Those other aspects are:

Table 2
Possible amendments staff think do not meet *Due Process Handbook* criteria

	Aspect of IAS 37	Possible deficiency	Reasons for rejecting	Research summary reference
1	Recognition criteria for provisions	'Probable outflows' criterion prevents recognition of some liabilities.	Users of financial statements do not regard recognition of provisions for low probability outflows as useful. So probable outflows criterion is consistent with the *Conceptual Framework*.	Section 2, paragraphs 2.1 – 2.10
2		Recognition thresholds are lower than those applied by entities applying US GAAP.	We have no reports that this difference causes additional problems in practice for entities with US operations that apply IFRS Standards.	Section 2, paragraphs 2.11 – 2.14
3	Requirements for measuring provisions	IAS 37 does not specify whether the 'best estimate' of the expenditure required to settle a single obligation is the most likely outcome or the expected value of possible outcomes.	Stakeholders (including users of financial statements) think IAS 37 should continue to allow management to apply judgement to decide which measure provides the best estimate of the outcome.	Section 3, paragraphs 3.4 – 3.15
4		Requirements for risk adjustments are unclear.	Stakeholders have not identified this matter as important.	Section 3, paragraphs 3.29 – 3.33

	Aspect of IAS 37	Possible deficiency	Reasons for rejecting	Research summary reference
5	Onerous contracts	Some stakeholders have requested for clarification of meaning of economic benefits and when to combine or segment contracts.	Other stakeholders think questions that arise in practice are best addressed by applying judgement on a case-by-case basis.	Section 4
6	Contingent assets	Settlement of a court case between the end of the reporting period and authorisation of the financial statements is treated as a 'non-adjusting' event for the entity with contingent asset.	Stakeholders acknowledge the asymmetry in the treatment of contingent assets and contingent liabilities, but do not regard it as important.	Section 5, paragraphs 5.2–5.8.
7	Reimbursement rights	Recognition criteria are too restrictive.	Stakeholders do not regard this matter as important enough to justify amendment.	Section 5, paragraphs 5.9–5.16
8	Scope of IAS 37	The scope is not quite wide enough for IAS 37 to be the default IFRS Standard for all liabilities not within the scope of another Standard.	Widening the scope may have no practical benefits and could have unintended consequences.	Section 6, paragraphs 6.1–6.9.
9	Terminology	The terms provision, contingent liability and contingent asset are open to misinterpretation.	Changes in terminology are disruptive and there is no significant demand for change from stakeholders.	Section 6, paragraphs 6.10–6.17.

Consultation on scope of a project to amend IAS 37

13. In March and April 2019, the Board sought views on the staff conclusions, which at that time were tentative. It sought views from national standard-setters and users and preparers of financial statements, by discussing the project at meetings of the ASAF, Capital Markets Advisory Committee (CMAC) and Global Preparers Forum (GPF). The staff also sought informal views from provisions specialists at IFRS desks of large accounting firms.

Feedback on the three targeted improvements suggested by staff[2]

14. Participants at all meetings discussed the three targeted improvements suggested by staff (Table 1 below paragraph 11). Participants at all meetings generally agreed that the Board should undertake a project to amend aspects of IAS 37 and that the project should include three suggested improvements.

15. Some participants expressed reservations about clarifying which costs to include in the measure of a provision. Their comments reflected concerns they also expressed about the Board's narrow-scope amendment to IAS 37 to clarify which costs an entity includes in assessing whether a contract is onerous.

16. Some participants expressed strongest support for aligning the IAS 37 liability definition and supporting guidance with those in the *Conceptual Framework*, especially if alignment included withdrawing IFRIC 21. However, a few of these participants cautioned that the Board should not underestimate the work required to develop requirements in this area—it would not be a narrow-scope project.

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2 Summarised for IASB May 2019 meeting, Agenda Paper 22 *Provisions—Education Session—Scope of possible project to amend IAS 37* and Agenda Paper 22B *Provisions—Extracts from ASAF, CMAC and GPF meeting notes*.

Suggestion for another improvement to IAS 37

Feedback received

17. At meetings with the ASAF and some accounting firms, participants noted that IAS 37 lacks a precise measurement objective. They suggested that without a clear measurement objective to refer to, the Board might have difficulty reaching decisions on two aspects of IAS 37 the staff suggested amending, that is which costs an entity should include in the measure of a provision and whether the rate at which an entity discounts a provision should reflect the entity's own credit risk. Participants suggested broadening the scope of the project to include specifying a clearer measurement objective.

Staff analysis

18. The staff do not think a clearer measurement objective is essential for the Board to decide reach decisions on the two matters discussed in paragraph 17. The staff think that without the constraint of a tightly-defined measurement objective, the Board could reach decisions on these two matters by considering what requirements would provide users of financial statements with the most useful information.

19. However, even if not essential, a clearer measurement objective in IAS 37 would have benefits and could be achieved by redrafting the existing objective and some existing requirements using the description of fulfilment value in the *Conceptual Framework*. To show what redrafting might be required, what benefits might be gained and where problems might arise, the staff have prepared an illustrative sketch. This sketch is shown in Appendix B to Agenda Paper 22A.

20. The staff think the main benefits of aligning the IAS 37 measurement objective and requirements with the *Conceptual Framework* would be that:

(a) the requirements would be clearer and would use terminology more consistent with that in other IFRS Standards, especially the more recent Standards;

(b) deleting the secondary measurement objective (paragraph 37) in IAS 37 would be the only substantive change. Deleting that paragraph would eliminate the main source of tension in the IAS 37 measurement requirements, that is the suggestion of a 'transfer' notion in the measurement objective.

(c) aligning the wording in IAS 37 with the *Conceptual Framework* description of fulfilment value might make it easier to site and draft additional requirements, for example, requirements specifying which costs an entity should include in the measure of a provision and whether the rate at which an entity discounts a provision should reflect the entity's own credit risk.

21. However, some people might question whether aligning the measurement objective and requirements with the *Conceptual Framework* would significantly affect the outcome of applying IAS 37, or make the requirements significantly easier to apply and enforce. Furthermore there would be drawbacks to adding this matter to the scope of the project. The amendments required would be more extensive than those required to make the two targeted improvements to the measurement requirements described in Table 1 above. Proposals to redraft some requirements (such as the requirement to make a risk adjustment) could raise questions about whether and how the redrafting changes the requirements. These questions could require additional consideration by the Board, prolonging the project and so delaying the issue of other amendments stakeholders view as important.

Staff conclusions

22. For the reasons in paragraph 21, the staff conclude that, on balance, the potential drawbacks of adding this matter to the scope of the project outweigh the potential benefits.

Feedback on matters the staff think should not be included in the project

23. We discussed the matters the staff think should *not* be included in the project (as listed in Table 2 following paragraph 12) at the ASAF meeting and informally with provisions specialists at IFRS desks of large accounting firms. There was general agreement that none of these matters should be included in a standard-setting project.

Consultation with IFRS advisory council

24. At its September meeting, the IFRS Advisory Council held a discussion on the possible move from the research programme to the standard-setting programme of the Subsidiaries that are SMEs project and the Provisions project. Advisory Council members did not disagree with the possible move.

Need for a discussion paper

25. The staff think the Board has sufficient information and understands the problem and solutions well enough to make a decision about a standard-setting project without a discussion paper.

Staff recommendations

26. On the basis of the analysis in this paper and the information summarised in Agenda Paper 22A, the staff recommends the Board adds to its standard-setting programme a project to amend aspects of IAS 37 and that the scope of the project comprises:
    (a) aligning the IAS 37 liability definition and requirements for identifying liabilities with the *Conceptual Framework*. The alignments could include withdrawing IFRIC 21 and replacing it with new requirements and illustrative examples.
    (b) clarifying which costs to include in the measure of a provision.
    (c) specifying whether the rate at which an entity discounts a provision for the time value of money should reflect the entity’s own credit risk.

Questions for the Board

Project proposal	
1	Are you satisfied the Board has sufficient information to make a decision on whether to add a project to amend aspects of IAS 37 to its standard-setting programme?
2	Do you agree the Board should add to its standard-setting programme a project to amend aspects of IAS 37, and that the scope of the project should include: (a) aligning the IAS 37 liability definition and requirements for identifying liabilities with the *Conceptual Framework*; (b) clarifying which costs to include in the measure of a provision; and (c) specifying whether the rate at which an entity discounts a provision for the time value of money should reflect the entity's own credit risk?
3	Do you agree the project should not include amending other aspects of IAS 37?

Next steps

27. If the Board decides at this meeting to add a project to its standard-setting programme, the staff will ask the Board to decide at a future meeting:

    (a) whether to publish a discussion document (for example a discussion paper) before developing an exposure draft; and

    (b) whether to establish a consultative group or other type of specialist advisory group.

    The staff will develop recommendations taking into account the decisions reached at this meeting about the scope of the project.

28. If the Board decides not to add a project to its standard-setting programme, the staff intend to develop a project summary to outline the evidence gathered and explain the Board's decision.