Provisions—Targeted Improvements to IAS 37

Breakout session 5
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

1. The entity has a present obligation as a result of a past event,
2. outflows are probable, and
3. 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

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

Earlier and progressive recognition of some levies

Clearer requirements, promoting consistent application
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 liability—no provision recognised

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.

Yes

Step 2
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?

Yes

Step 3

No

No liability—no provision recognised

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?

Yes

✓ Present obligation criterion satisfied
Provision recognised if two other criteria are also satisfied.

No

No liability—no provision recognised

If...
✓ outflows are probable
✓ amount can be reliably estimated
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?

<table>
<thead>
<tr>
<th>Conditions</th>
<th>1 Strength</th>
<th>2 Nature</th>
<th>3 Timing</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Strength</td>
<td>No practical ability to avoid?</td>
<td>Transfer an economic resource?</td>
<td>Entity has taken one of the specified actions?</td>
</tr>
<tr>
<td>2 Nature</td>
<td></td>
<td></td>
<td>And has no practical ability to avoid remaining specified actions?</td>
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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 CO₂ 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>
<thead>
<tr>
<th>Conditions</th>
<th>(a)</th>
<th>(b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Strength</td>
<td>No practical ability to avoid?</td>
<td>✓ 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>
</tr>
<tr>
<td>3 Timing</td>
<td>Entity has taken the specified action?</td>
<td>✗</td>
</tr>
</tbody>
</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?

<table>
<thead>
<tr>
<th>Conditions</th>
<th>1 Strength</th>
<th>✓</th>
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<td></td>
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<td>✓</td>
</tr>
</tbody>
</table>
Comparison: net zero commitment (Example 2) versus restructuring plan (Example 3)

Restructuring plan
- Receive employee services (Action to meet timing condition)
- Restructuring announcement (All 3 conditions met)
- Present obligation at time of announcement?
  ✓

Net zero commitment
- Net zero announcement (Timing condition not met)
- Emissions (Action to meet timing condition)
- Present obligation at time of announcement?
  ✗
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 CO2 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.

**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
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