Staff paper

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IASB® meeting

Date	**June 2025**
Project	**Provisions—Targeted Improvements**
Topic	**Exposure Draft feedback—Costs to include**
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Purpose of paper

1. The International Accounting Standards Board (IASB) published Exposure Draft *Provisions—Targeted Improvements* (Exposure Draft) in November 2024, with a comment deadline of 12 March 2025. The Exposure Draft proposes amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

2. At this meeting, the IASB will discuss feedback on the Exposure Draft proposals. We are not asking the IASB to make decisions at this meeting. However, comments from IASB members will help us develop recommendations for the direction of this project.

3. Agenda Paper 22 *Provisions—Targeted Improvements—Exposure Draft feedback—Overview* provides an overview of the Exposure Draft proposals, the sources of feedback and the key messages in the feedback. It also explains the terms we have used to quantify the number of stakeholders expressing a view.

4. This paper summarises feedback on proposals to specify the costs an entity includes in estimating the future expenditure required to settle an obligation (costs to include).

5. This paper summarises the main matters raised by respondents on these proposals. We will include feedback on more minor and drafting matters in papers we prepare for future IASB discussions.

Contents of this paper

6. The paper summarises feedback on:

    (a) the proposed requirement (paragraphs 11–23); and

    (b) the scope of the proposed requirement (paragraphs 24–27).

7. A question following paragraph 27 invites IASB members to ask questions and comment on the feedback summarised in this paper.

Proposed requirement

Exposure Draft proposal (paragraph 40A)

8. IAS 37 requires an entity to measure a provision at the best estimate of the expenditure required to settle the present obligation.

9. The Exposure Draft proposes to specify that the expenditure required to settle an obligation comprises the costs that relate directly to the obligation and that such costs consist of both (a) the incremental costs of settling that obligation and (b) an allocation of other costs that relate directly to settling obligations of that type.

10. The proposed requirement stems from the IASB's previous amendment to IAS 37, *Onerous Contracts—Cost of Fulfilling a Contract* (issued in May 2020), which specified the costs an entity includes in *assessing* whether a contract is onerous. Applying the proposed requirement, an entity would include the same types of costs in *measuring* an onerous contract provision.

Feedback

Agreement with the proposal

11. Most respondents agree with the proposal on costs to include. Almost half of the respondents who agree do not explain their reasons for agreeing or provide any additional comments.

12. Of those respondents who do give reasons, many say they agree with the proposal because it would align requirements *within* IAS 37. For example:

    (a) many respondents support the proposal that entities include the same types of costs in *assessing* whether a contract is onerous and in *measuring* an onerous contract provision, in line with the previous *Onerous Contracts—Cost of Fulfilling a Contract* amendment.

    (b) a few respondents say the proposal would ensure that entities measure onerous contract provisions consistently with other types of provisions.

13. A few respondents also say they agree with the proposal because it would help align requirements *across* IFRS Accounting Standards:

    (a) a group of academics from a European university say the proposed requirement would reflect the 'fulfilment value' measurement objective set out in paragraph 6.17 of the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*).[1]

    (b) two national standard-setters (in Europe) say the proposed requirement would align IAS 37 with various other IFRS Accounting Standards which similarly require the inclusion of direct costs when recognising an asset.

[1] Paragraph 6.17 of the *Conceptual Framework* defines 'fulfilment value' as 'the present value of the cash, or other economic resources, that an entity expects to be obliged to transfer as it fulfils a liability. Those amounts of cash or other economic resources include not only the amounts to be transferred to the liability counterparty, but also the amounts that the entity expects to be obliged to transfer to other parties to enable it to fulfil the liability.'

14. Respondents say the alignments mentioned in paragraphs 12–13 would improve comparability and reduce diversity in practice. In addition, two accounting bodies (in Africa and Europe) say applying the proposed requirement would result in a more faithful representation of the obligation underlying a provision.

15. A few respondents specifically comment on the practicability of the proposal:

    (a) two national standard-setters (in Asia-Oceania and Europe) describe the proposal as ‘reasonable and applicable to a wide range of provisions’ and ‘workable in practice’. Furthermore, an accounting body (in Europe) says the proposal reflects current practice among preparers.

    (b) a preparer (an insurer) says entities might need to obtain additional information to determine costs that relate directly to settling an obligation. However, the preparer says doing so would not be ‘overly complex or cost-prohibitive’.

16. Despite agreeing with the proposed requirement, the national standard-setter (in Asia-Oceania) and the preparer referred to in paragraph 15 say ‘a high level of judgement’ would be required in applying it, thereby potentially resulting in diversity in practice.

17. Some respondents suggest refinements to the proposal. For example:

    (a) a national standard-setter (in Europe) suggests allowing an entity to measure a provision at either its ‘fulfilment value’ or ‘transfer value’ to maintain alignment with the existing requirements in paragraph 37 of IAS 37.

    (b) a few respondents suggest clarifying whether, in applying the existing paragraph 68 of IAS 37[2], an entity would measure a provision at the lower of (i) the cost of settling the obligation (for example, by continuing to fulfil an onerous contract) or (ii) the cost of *avoiding* settling the obligation (for example, by cancelling an onerous contract and paying any cancellation fee).

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2 Paragraph 68 of IAS 37 states: ‘This Standard defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contact, which is the lower of the cost of fulfilling it and any compensation or penalties arising from the failure to fulfil it.’

(c) some respondents suggest fully aligning the wording in the proposed paragraph 40A of the Exposure Draft with that in the existing paragraph 68A of IAS 37. Paragraph 68A includes examples of (a) incremental costs of fulfilling a contract and (b) an allocation of other costs that relate directly to fulfilling contracts. The respondents say including these examples in the proposed paragraph 40A would ensure that entities include the same types of costs in both *assessing* an onerous contract and *measuring* an onerous contract provision.

(d) a national standard-setter (in Asia-Oceania) suggests incorporating into IAS 37 paragraph BC66 of the Basis for Conclusions, which explains the IASB's views underlying the proposal.

Disagreement with the proposal

18. A few respondents disagree with the proposal:

(a) a preparer and a preparer group (both in North America) question the need to align the types of costs an entity should include in in *assessing* whether a contract is onerous and in *measuring* an onerous contract provision. In the view of the preparer group:

> Costs considered in an onerous contract assessment are those that are necessary to fulfil a contract (including an allocation of "fixed costs"). However, a provision should include the unavoidable costs to settle the obligation. Therefore, we believe the existing guidance provided in paragraph 36 in IAS 37 is appropriate. *CL55 Canadian Bankers Association*

(b) a European academic group—which had previously disagreed with the *Onerous Contracts—Cost of Fulfilling a Contract* amendment—says neither the *Conceptual Framework* nor other IFRS Accounting Standards provide sufficient guidance on the nature of costs, particularly in the context of provisions. The respondent suggests the IASB undertake conceptual work on the subject instead.

19. Some respondents express concern specifically about including an 'allocation of costs that relate directly to settling obligations of that type' in the measurement of a provision. Respondents say this aspect of the proposal would:

    (a) *be costly and difficult to apply.*
    A preparer (in the oil and gas industry) refers to the difficulty of estimating costs for settling long-term obligations. A few respondents (mainly preparers) say entities might need to acquire analytical tools to identify and allocate costs accurately. Another preparer (also in the oil and gas industry) doubts whether the benefits of applying the proposed requirement would outweigh the costs.

    (b) *increase diversity in practice and reduce comparability.*
    A few respondents (mainly preparers) say the allocation would require a high level of judgement. Respondents say that, in the absence of more specific guidance, entities might need to develop their own policies, which could undermine comparability and usefulness of information.

    (c) *not provide useful information.*
    A few respondents express concern about bringing forward the recognition of costs that will be incurred—and otherwise be recognised—to operate in the future. They say that including these costs is tantamount to recognising provisions for future operating costs (or for obligations to exchange economic resources)—contrary to the fundamental objectives of the recognition requirements in IAS 37 (as discussed in paragraphs 42–45 of Agenda Paper 22C *Exposure Draft feedback—Present obligation criterion—other requirements*).

    These respondents say that including future operating costs could distort current period financial performance, fail to reflect the economic reality of those costs, and inadvertently lead to double counting. One preparer questions the usefulness of the proposal, describing it as 'a reclassification exercise'.

(d) *be ineffective.*

An academic group (in Europe) warns that the proposed requirement could be ineffective:

> …the total cost of an existing otherwise idle asset could (in our view, justifiably) be allocated to profitable production and none to the contract that is possibly onerous. Thus the requirement to include an allocation of costs may not be effective. *CL13 European Accounting Association*

20. A few respondents agree with requiring entities to include the same types of costs in *assessing* whether a contract is onerous and *measuring* an onerous contract provision. Nonetheless, they express concern that requirements that should apply specifically to onerous contracts would now apply to other types of provisions. For example, a preparer group (in Europe) says the costs of settling an onerous contract provision have a different nature from those of settling other types of obligations. For these other types of provisions, the respondent suggests including only incremental costs.

Suggestions and requests for guidance

21. Some respondents request additional guidance and illustrative examples to clarify which types of costs should be included in the measurement of provisions. Most of these respondents ask how an entity should include 'an allocation of other costs that relate directly' to settling an obligation.

22. Some respondents ask for guidance on:

(a) whether to include the costs of an item of property, plant and equipment (PPE) used in settling an obligation (such as environmental rehabilitation) and, if so, whether those costs should comprise:

(i) the cash flows involved in purchasing the item of PPE; or

(ii) the depreciation charge relating to using the item of PPE.

(b) whether to allocate the depreciation charge for an item of PPE if that item is also used for purposes beyond settling the obligation. A few respondents say entities currently do not perform such an allocation.

(c) whether to deduct cash recoveries (such as those earned from reprocessing and selling waste).

(d) whether to include all costs in real terms (adjusted for inflation) or nominal terms (not adjusted for inflation).

23. Some respondents suggest refinements to the proposed requirements. For example:

(a) a preparer (in the oil and gas industry) requests 'practical expedients that could ease the burden of applying the proposed amendments'.

(b) a regulator group (in Europe) suggests requiring an entity to disclose 'material cost components included in estimating future expenditures'. The respondent says this information might be useful to users of financial statements.

Scope of the proposed requirement

Exposure Draft proposal

24. The IASB developed the costs to include proposal in the context of provisions for onerous sales contracts and other obligations that an entity settles by providing *goods or services* to a counterparty. The proposed requirement clarifies that, in measuring an obligation that will be settled by transferring goods or services to a counterparty, an entity should include both the incremental costs and an allocation of other costs that relate directly to producing and transferring those goods or services.

25. The IASB did not discuss the possible implications of the proposed requirement for obligations that an entity settles by *paying cash* to a counterparty (for example, litigation claims), but that might require the entity to procure goods or services (for example, legal services) on its own behalf in settling the obligation (ancillary costs).

Feedback

26. Some respondents ask the IASB to clarify the implications of the proposed costs to include requirement for ancillary costs—especially the costs of legal services procured in settling litigation provisions:

    (a) some question whether the requirement would apply to *all* provisions (as implied in the Exposure Draft) or only to provisions that will be settled by transferring goods or services, rather than by paying cash, to the counterparty (as suggested in the staff webcast accompanying the Exposure Draft). These respondents suggest clarifying the scope of the proposal.

    (b) some respondents assume that the requirement would apply to all provisions and question its implications for ancillary costs. They ask whether an entity would be required to include ancillary costs in the measure of a provision and, if so, which ancillary costs—for example, should an entity include:

        (i) fees paid to third parties (such as lawyer fees); and

        (ii) an allocation of internal costs (such as salaries paid to staff working in the entity's internal legal department)?

27. In the case of a provision arising from litigation, a few respondents say they have observed diversity in whether external legal fees are included in the measure of a provision.

Question for the IASB

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Do you have any questions or comments on the feedback reported in this paper?