International Financial Reporting Standards

Conceptual Framework Exposure Draft

Implications of proposals

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The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

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Before we start…

- You can download the slides by clicking on the event resources button to the left side of your screen
- This webinar is a recording (it is not live), so we are unable to take any questions
- The views expressed are those of the presenters, not necessarily those of the IASB or IFRS Foundation

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Conceptual Framework webinar schedule

Previously-recorded webinars	
17 / 06	Overview of Conceptual Framework Exposure Draft
06 / 08	Chapter 4 and 5—the elements of financial statements: definitions and recognition
13 / 08	Chapter 4—a closer look at liabilities and executory contracts
20 / 08	Chapter 6—measurement
27 / 08	Chapter 7—classification of income and expenses (profit or loss vs. OCI)
03 / 09	Chapter 5—derecognition of assets and liabilities
10 / 09	Chapter 3—the reporting entity
17 / 09	Chapters 1 and 2—objectives and qualitative characteristics
This webinar	
24 / 09	Possible implications of the proposals—with provisions and contingent liabilities case study

Immediate implications

Immediate implications

- The *Conceptual Framework* is not a Standard and does not override specific Standards.
- Entities will be affected only if a particular Standard requires them to apply the *Conceptual Framework, eg* to select an accounting policy for a particular transaction:
  1. if no Standard specifically applies (IAS 8); or
  2. if a Standard permits a choice of accounting policies (IAS 1).

Exposure Draft *Updating References to the Conceptual Framework*

- Changes in accounting policy to be accounted for retrospectively.
- Transition period of 18 months between issue of revised *Conceptual Framework* and effective date.
- Early application permitted.

Implications for future standard-setting

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- IASB will not automatically change any existing Standards or Interpretations to make them consistent with the revised *Conceptual Framework*.

- But if IASB undertakes a project to develop a new Standard or amend an existing Standard, it will be guided by the revised *Conceptual Framework*.

Case Study

Possible implications
for
provisions, contingent liabilities and contingent assets (IAS 37)

Case study – implications for IAS 37

1	**IAS 37 guidance on identifying liabilities** (When does an entity have a present obligation?)
2	**IAS 37 recognition criteria**
3	**IAS 37 measurement requirements**

Existing guidance in IAS 37 appears contradictory

Paragraph 19

Only obligations ‘existing independently of an entity’s future actions … are recognised as provisions’.

Vs

Paragraph 10

Obligating event = an event that results in the entity having no realistic alternative to settling the obligation.

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IFRIC 21 *Levies* – no liability while entity could take actions to avoid payment (even if such actions are not realistic).

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IFRIC 21 *Levies* – no liability while entity could take actions to avoid payment (even if such actions are not realistic).

Vs

Paragraph 10

Obligating event = an event that results in the entity having no realistic alternative to settling the obligation.

Restructuring costs – liability once plan has been announced. Withdrawal of plan possible in theory, but not a realistic alternative in practice.

Implications for IAS 37 – identifying liabilities

Proposed concepts could provide a basis for improved guidance

4.31 Present obligation

An entity has a present obligation to transfer an economic resource if both:

a) the entity has no practical ability to avoid the transfer; and

b) the obligation has arisen from past events, ie the entity has received the economic benefits, or conducted the activities, that establish the extent of its obligation.

4.35 Conditional obligations

It is not necessary for the obligation to be unconditional.

Liabilities may be conditional on a particular future action of the entity…

…if the entity has no practical ability to avoid that action.

Requirements for levies could change

Levies

- Liabilities may be identified earlier than at present, ie before activity that triggers payment.
- Liabilities would be identified earlier if:
  - amount of levy is established by reference to earlier activities; and
  - when entity conducts those earlier activities, it has no practical ability to avoid later activity that triggers payment.
- Liabilities for many accumulating periodic levies would be recognised incrementally over the period to which the levy refers.

Implications for IAS 37 – identifying liabilities

Requirements for restructuring costs could be expressed differently

Restructuring costs

- Announcement of restructuring plan would not be sufficient to give rise to a liability.
- But could be evidence that entity has no practical ability to avoid restructuring costs.
- So if entity has received benefits or conducted activities that establish extent of costs, announcement could be event that triggers identification of a liability.

Case study – implications for IAS 37

1	**IAS 37 guidance on identifying liabilities** (When does an entity have a present obligation?)
2	**IAS 37 recognition criteria**
3	**IAS 37 measurement requirements**

IAS 37 recognition criteria are different from those in other Standards

Provisions within the scope of IAS 37 are recognised if:

1) it is more likely than not that a present obligation exists; and
2) it is probable (more likely than not) that an outflow of resources will be required to settle the obligation; and
3) a reliable estimate can be made of the amount of the obligation.

Implications for IAS 37 – recognition criteria

Proposed concepts may justify differences between IAS 37 and other Standards

Conceptual Framework Exposure Draft proposals

- Failure to recognise assets and liabilities makes financial statements less complete and can exclude useful information.
- But recognition of some items does not provide useful information.
- An entity should recognise an asset or liability if doing so provides:
  - relevant information;
  - a faithful representation; and
  - benefits that exceed costs.

Recognition might not provide relevant information if:

- it is uncertain whether an asset or liability exists.
- there is only a low probability that an inflow or outflow of economic benefits will result.
- all available measures of the liability have a high level of measurement uncertainty.

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Implications for IAS 37 – recognition criteria

Proposed concepts could provide a basis for retaining the existing recognition criteria in IAS 37

- Consistency with other Standards would not in itself be a reason for changing IAS 37.
- Liabilities within scope of IAS 37 have characteristics that distinguish them from other liabilities. They typically cannot be measured by reference to an observable transaction price (even historical cost).
- Other ways of measuring liabilities can be difficult and subject to more measurement uncertainty.
- Arguably, the three existing criteria filter out liabilities for which costs of recognition would exceed benefits.

Case study – implications for IAS 37

1	**IAS 37 guidance on identifying liabilities** (When does an entity have a present obligation?)
2	**IAS 37 recognition criteria**
3	**IAS 37 measurement requirements**

Aspects of the IAS 37 measurement requirements are unclear

Incremental costs only? Or include allocation of indirect costs?

36 The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

Most likely outcome or average of all possible outcomes?

37 The best estimate … is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time.

Which one? Does it depend on the circumstances?

Aspects of the IAS 37 measurement requirements are unclear

42 The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision.

43 Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured.

47 The discount rate … [shall reflect] … the risks specific to the liability.

What is the objective? How could it be achieved?

When is a risk adjustment required?

Do these risks include the entity's own credit risk?

Implications for IAS 37 – measurement requirements

Proposed concepts would provide some direction

Proposed concept	Implications for IAS 37
6.54 To produce relevant information, it is important to consider how the asset or liability contributes to future cash flows.	Entities tend to settle most liabilities within scope of IAS 37 by fulfilling obligations themselves. This could lead the IASB to focus on 'fulfilment value', ie the present value of the cash flows that an entity expects to incur as it fulfils a liability.

Implications for IAS 37 – measurement requirements

Proposed concepts would provide some direction

Proposed concept

6.35 In principle, fulfilment value reflects:

- estimates of future cash flows,
- possible variations in amount and timing of cash flows,
- price for bearing uncertainty inherent in cash flows (risk adjustment),
- the time value of money.

In practice, to provide most useful information, fulfilment value may sometimes need to be customised.

Implications for IAS 37

IASB could consider whether and how to customise fulfilment value to provide most useful information about liability and expense, and to take account of cost constraint.

Eg, IASB might consider:

- 'most likely outcome' measurements for some liabilities
- excluding effect of own credit risk, and possibly excluding any risk adjustment.

Further information

About the research project on provisions, contingent liabilities and contingent assets

- Project page within research projects section of IASB website

  Provisions, Contingent Liabilities and Contingent Assets

- Staff papers discussed at IASB Education session in July 2015:

  Paper 14A *Project overview*
  Paper 14B *Possible problems with IAS 37*
  Paper 14C *Implications of Conceptual Framework proposals*

  Board discussion and papers

About the 2015 Agenda Consultation

- Information page on IASB website

  Request for Views: 2015 Agenda Consultation

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Further information

About the Conceptual Framework project

- Exposure Draft *Conceptual Framework for Financial Reporting*
  http://go.ifrs.org/ED-CF-May2015
- Conceptual Framework website
  http://go.ifrs.org/Conceptual-Framework
- Submit a comment letter
  http://go.ifrs.org/comment_CF
- Snapshot
  http://go.ifrs.org/CFSnapshot2015
- Register for email alerts
  http://eifrs.ifrs.org/eifrs/Register