Staff paper

IFRS® Interpretations Committee meeting

Date	**November 2023**
Project	**Provisions**
Topic	**Present obligation recognition criterion**
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IFRS® Interpretations Committee meeting, November 2023, Agenda paper 6A
This paper was discussed at the International Accounting Standards Board's (IASB's) April 2023 meeting as Agenda Paper 22. Agenda papers referred to in this paper are other agenda papers for the IASB's April 2023 meeting, unless otherwise noted.

Session overview

1. At this session, the IASB will discuss possible amendments to requirements and guidance in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The amendments would be to:
   (a) the definition of a liability;
   (b) the wording of the recognition criterion applying that definition—the requirement for an entity to have a present obligation as a result of a past event (the present obligation recognition criterion); and
   (c) requirements and guidance supporting that recognition criterion.

2. The IASB has already developed concepts on which to base those amendments, adding those concepts to its *Conceptual Framework for Financial Reporting*

(Conceptual Framework) in 2018. The staff have now applied those concepts in developing initial suggestions for amendments to IAS 37.

3. The purpose of the meeting is to give IASB members an opportunity to comment on and ask questions about our suggestions. IASB members will not be asked to make any decisions at this meeting.

4. After this meeting, we plan to update the suggestions in light of the IASB members' comments, and then seek views on the possible amendments from members of some of the IASB's advisory groups. Informed by the feedback from those groups, we will develop recommendations for possible amendments, and ask the IASB to tentatively approve those recommendations at a future IASB meeting.

Contents of this paper

5. This paper contains:

Paper contents	Paragraphs
Background information Explaining: (a) the scope of this project to make targeted improvements to IAS 37; (b) why the IASB is considering amending the requirements and guidance supporting the present obligation recognition criterion; (c) problems experienced with the existing requirements and guidance; and (d) progress the IASB has already made towards developing possible amendments—revisions to the *Conceptual Framework* in 2018.	7–31

Paper contents	Paragraphs
Staff suggestions for possible amendments Suggestions for: (a) updates to the definition of a liability and the wording of the present obligation criterion; (b) changes to some requirements supporting the present obligation recognition criterion; (c) clarification of other requirements supporting that criterion; (d) improved explanations of the reasons for some of the application requirements and illustrative examples; and (e) absorption of IFRIC Interpretations and IFRS Interpretations Committee agenda decisions.	32–65
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6. The appendices accompanying this paper illustrate the drafting implications of the possible amendments to:

(a) IAS 37—see Appendix A; and

(b) illustrative examples accompanying IAS 37—see Appendix B.

Background information

Project scope

7. In this project, the IASB is developing proposals to make three targeted improvements to IAS 37:

   (a) to amend the liability definition and the requirements and guidance supporting the present obligation recognition criterion, applying concepts added to the *Conceptual Framework for Financial Reporting* in 2018;

   (b) to specify more precisely the rate an entity uses to discount a long-term provision to its present value; and

   (c) to specify which costs an entity includes in measuring an obligation to provide goods or services.

Why amend the requirements and guidance supporting the present obligation recognition criterion?

8. Paragraph 10 of IAS 37 defines a provision as a liability of uncertain timing or amount. It defines a liability as:

   > A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

9. One of the criteria in IAS 37 for recognising a provision is that the definition of a liability is met—paragraph 14(a) requires that the entity 'has a present obligation (legal or constructive) as a result of a past event'. Paragraphs 15–22 of IAS 37 set out requirements for identifying when an entity has such an obligation, and examples accompanying IAS 37 illustrate the application of those requirements. The IASB is considering amending the requirements and examples because of problems that have arisen in practice in applying them.

> **Note**
>
> The amendments would affect only the present obligation recognition criterion. They would *not* affect the other two recognition criteria in IAS 37—the 'probable outflows' and 'reliable measurement' criteria. In other words, IAS 37 would continue to require an entity to recognise a present obligation as a provision only if:
>
> - it is probable that an outflow of resources will be required to settle the obligation (paragraph 14(b) of IAS 37); and
> - a reliable estimate can be made of the amount of the obligation (paragraph 14(c) of IAS 37).

Problems experienced with the existing requirements and guidance

10. The problems experienced in applying the existing requirements and guidance have included:

    (a) difficulties in disentangling two distinct criteria within the present obligation criterion (paragraphs 11–15);

    (b) dissatisfaction with IFRIC 21 *Levies*, which interprets the present obligation criterion (paragraphs 16–18); and

    (c) further questions arising in applying IAS 37 to climate-related regulations and commitments (paragraphs 19–21).

Difficulties in disentangling two distinct criteria within the present obligation criterion

11. IAS 37 identifies two criteria within the present obligation criterion:

    (a) there must have been a past event creating a present obligation, and

    (b) the entity must have no realistic alternative to settling that obligation.

12. Although these are two distinct criteria, IAS 37 does not describe them separately. It wraps both criteria into the definition of an obligating event, which it defines as 'an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling the obligation'. It then discusses both criteria within a single section of guidance (paragraphs 17–22 of IAS 37).

13. Problems arise because it is unclear which one of the two criteria some of the guidance is referring to. For example, paragraph 19 talks about an entity not having a present obligation if it can avoid 'future expenditure' by its future actions. The intended meaning is that an entity should not recognise a provision if it can avoid *incurring* an obligation through its future actions. But people read 'expenditure' as referring to settlement—an entity should not recognise a provision if it could avoid *settling* the obligation through its future actions (even if the actions required to avoid settlement are not realistic).

14. In essence, the problem is that IAS 37 does not make a clear distinction between

    (a) actions that *give rise to* an obligation—which must have occurred in the past (a timing fact); and

    (b) actions that *settle* an obligation—which the entity will have to take in the future because it has no realistic alternative to settling the obligation (an enforceability assessment).

15. The result is that it can be difficult to apply IAS 37 to situations in which a past event of an entity could result in an outflow of economic resources, but the entity might avoid that outflow through its future actions. Should management conclude that the entity:

    (a) does not have a present obligation; or

    (b) the entity has a present obligation that it should recognise if the actions required to avoid the outflow are not realistic?

Dissatisfaction with IFRIC 21

16. In response to requests for more guidance for specific fact patterns, the IFRS Interpretations Committee issued two Interpretations: IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* and IFRIC 21 *Levies*. In both cases, the Committee applied paragraph 19 of IAS 37 and concluded that an entity does not have a present obligation until it takes the actions to which a charge is linked—even if the entity has no realistic alternative to taking those actions.

17. The consensus in IFRIC 21 addressed circumstances in which a levy is charged only if an entity takes both (or all) of two (or more) specified actions—for example, if an entity generates revenue in a market in one year and is still operating in that market on a specified date in the next year. IFRIC 21 clarified that the liability arises only when the entity takes the second (or last) of those actions, triggering the outflow.

18. However, the Interpretations have not resolved the matter:

    (a) the Interpretations appear inconsistent with other requirements in IAS 37, especially requirements for restructuring costs. IAS 37 requires entities to recognise liabilities for restructuring costs when they have announced or started to implement a restructuring plan. The rationale is that, once an entity has announced a plan, it has no realistic alternative other than take the future actions that will trigger charges. Stakeholders have said it is unclear why one principle applies to levies and another to restructuring costs, and hence which principle should apply to other transactions within the scope of IAS 37.

    (b) IFRIC 21 has been criticised by a range of stakeholders, including users, preparers and auditors of financial statements and national standard setters. IFRIC 21, in combination with IFRS Standards addressing the identification and recognition of assets (such as IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*), results in some recurring periodic levies being recognised as expenses at a single point in time.

Stakeholders, including investors, have expressed concern about this outcome because they believe that the economic substance of a recurring levy is that the entity is paying to operate over a period, and that this substance would be more faithfully represented by recognising the expense gradually over that period.

(c) the consensus in IFRIC 21 is inconsistent with requirements in other IFRS Standards that address obligations that depend on two or more actions of the entity. For example, IFRS 2 *Share-based Payments* addresses liabilities for cash-settled share-based payments, including those that payable only if an entity receives employee (or other) services in on year *and* achieves performance-based targets in later years. It requires an entity to recognise a liability when it receives the services—even if at that time the payment is conditional on performance-based targets and will be triggered only if those targets are met. In such situations, the liability is recognised even though the entity could still, in theory at least, avoid the payment through its future actions.

Further questions arising in applying IAS 37 to climate-related regulations and commitments

19. Recently, more questions have arisen about the application of the present obligation recognition criterion, especially in relation to climate-related regulations and commitments. Questions have arisen about situations in which:

(a) responsibilities imposed by climate-related laws and regulations are not enforceable in conventional ways—they are structured so an entity is not compelled to comply but nevertheless may have a strong economic incentive to do so; or

(b) an entity makes a public commitment to change its method of operation—for example to reduce greenhouse gas emissions to 'net zero'—in the future.

20. The IFRS Interpretations Committee recently considered some of those questions in relation to a government's measures to encourage vehicle producers to produce low emission vehicles. In that fact pattern, the government had no right to compel producers to comply with the measures but had a right to impose economic sanctions on those that failed to comply—for example, restricting their market access in the future.

21. The Committee reached conclusions on how to apply IAS 37 to those measures, publishing those conclusions in Agenda Decision Negative Low Emission Vehicle Credits in July 2022.[1] However, the questions generated significant debate among Committee members, and extensive analysis was required to explain the Committee's conclusions. The Committee might have found the questions easier to answer (indeed the questions might never have reached the Committee):

    (a) if IAS 37 more clearly distinguished actions that give rise to an obligation (which must have occurred in the past) from actions that settle the obligation (which will occur in the future if the entity has no realistic alternative to settling the obligation);

    (b) if the conclusions in illustrative examples 6 (smoke filter) and 11B (aircraft overhaul) accompanying IAS 37 were better explained—so it was clearer why the conclusions for the fact pattern considered by the Committee differed from those examples 6 and 11B, and

    (c) if IAS 37 provided better guidance on the factors to consider in assessing whether an entity has a realistic alternative to settling an obligation. At present, paragraph 17 of IAS 37 requires that a legal obligation 'can be enforced by law'. However, it gives no guidance on how to apply this requirement if a counterparty cannot use the courts to enforce compliance, but has a legal right to impose market-based sanctions that might leave an entity with no realistic alternative other than to comply.

[1] Project pages: https://www.ifrs.org/projects/completed-projects/2022/negative-low-emission-vehicle-credits-ias-37/
Agenda decision: https://www.ifrs.org/content/dam/ifrs/supporting-implementation/agenda-decisions/2022/negative-low-emission-vehicle-credits-jul-2022.pdf.

Progress already made towards developing possible amendments—revisions to the Conceptual Framework in 2018

New concepts added to the Conceptual Framework

22. The criticisms of IFRIC 21 described in paragraph 18 highlighted a question the IASB has had to consider in developing various IFRS Accounting Standards over the years —whether, and if so when, a liability arises for an obligation that depends on two or more actions of the entity—is it as soon as the first action occurs, or only when the last action occurs triggering the outflow? Because the same question arises for various types of transactions—for example, for share-based payments, variable lease payments and purchases subject to variable or contingent consideration—the IASB decided to answer it at a conceptual level, as part of its *Conceptual Framework* project. The concepts it developed to address this question were among those it added to the *Conceptual Framework* in 2018.

23. Although the IASB designed those concepts to have general applicability, it developed them with the problems of IAS 37 in mind. It included concepts it could readily apply to develop requirements for IAS 37 that would resolve its apparent contradictions and result in information that investors find more useful.

24. Most notably the *Conceptual Framework* now includes concepts defining when an entity has a present obligation as a result of a past event. Paragraphs 4.43 and 4.44 of the *Conceptual Framework* state that:

> 4.43 A present obligation exists as a result of past events only if:
>
> (a) the entity has already obtained economic benefits or taken an action; and
>
> (b) as a consequence, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer.
>
> 4.44 … If economic benefits are obtained, or an action is taken, over time, the resulting present obligation may accumulate over that time.

25. The IASB also included concepts on the meaning of 'obligation', including on whether and how the presence or absence of realistic alternatives would affect the identification of an obligation. The *Conceptual Framework* uses different terminology from IAS 37—it refers to an entity's 'practical ability to avoid' an obligation rather than its 'realistic alternative to settling' the obligation—but the *Conceptual Framework* terminology is intended to have the same meaning as the IAS 37 terminology.

26. Several paragraphs in the *Conceptual Framework* discuss the concept of 'no practical ability to avoid'. Notably:

(a) paragraph 4.29 the *Conceptual Framework* states as a general concept that:

> An obligation is a duty or responsibility that an entity has no practical ability to avoid. …

(b) paragraph 4.32 specifically addresses situations in which an entity's duty or responsibility to transfer an economic resource is conditional on the entity's own future actions:

> In some situations, an entity's duty or responsibility to transfer an economic resource is conditional on a particular future action that the entity itself may take. Such actions could include operating a particular business or operating in a particular market on a specified future date, or exercising particular options within a contract. In such situations, the entity has an obligation if it has no practical ability to avoid taking that action.

27. Applying these concepts in the context of IAS 37 would change the timing of recognition of some provisions. The timing would change if an obligation to transfer an economic resource depends on two or more actions of the entity, and these actions occur at different times. At present, applying paragraph 19 of IAS 37 (as interpreted by IFRIC 21), an entity recognises a provision only when it has taken the *last* of the required actions, triggering the transfer (assuming that, at that time, the 'probable outflows' and 'reliable measurement' recognition criteria are also met). If the entity

were to apply instead paragraphs 4.32 and 4.43 of the *Conceptual Framework*, it would recognise a provision as soon as it has taken *any* of the actions and has no practical ability to avoid the other actions (again assuming that, at that time, the other recognition criteria are also met). The practical consequences would be that the liability would be recognised earlier and, in many cases, would be recognised progressively over a period, rather than all at once at a point in time.

Updated liability definition and clearer separation of the 'past event' and 'no practical ability to avoid' criteria

28. When the IASB revised the *Conceptual Framework* in 2018, it revised the definition of a liability, replacing the old definition from the previous version of the *Conceptual Framework* (and reproduced in IAS 37) with a new definition:

> A present obligation of the entity to transfer an economic resource as a result of past events.

29. Like IAS 37, the *Conceptual Framework* identifies two criteria that must be met for an entity to have a present obligation as a result of past events:

    (a) there must have been a past event creating a present obligation, and

    (b) the entity must have no realistic alternative to settling (or, in *Conceptual Framework* terminology, no practical ability to avoid) that obligation.

30. However, unlike IAS 37, the *Conceptual Framework* clearly distinguishes these two criteria. It does not use the term 'obligating event' or any other term that encompasses both requirements. Instead, each criterion is discussed separately in its own section of the *Conceptual Framework*.

31. The *Conceptual Framework* also includes concepts explaining the meaning of 'to transfer an economic resource'. Paragraph 4.37 states that an obligation must have the potential to require the entity to transfer an economic resource but that it need not be certain, or even likely, that a transfer will be required.

Staff suggestions for possible amendments

32. The staff have applied the new *Conceptual Framework* definition of a liability and supporting concepts as the basis for initial suggestions for amendments to IAS 37 and its accompanying illustrative examples.

33. We explain those suggestions below, grouping them into five categories:

(a) Updates to the definition of a liability and the wording of the present obligation criterion. These changes would eliminate an out-of-date definition from IFRS Accounting Standards, and we think they would have no effect on the application of IAS 37.

(b) Changes to some requirements supporting the present obligation recognition criterion—specifically, changes to requirements affecting the timing of recognition of provisions for obligations (typically levies) that depend on two or more actions of the entity. Changing those requirements would change the way *all* entities apply them.

(c) Clarification of other requirements supporting the present obligation recognition criterion—for example, to distinguish more clearly the two criteria for a present obligation, and to provide more guidance on the meaning of 'can be enforced by law'. Clarifying these requirements could reduce diversity in practice, changing the way *some* entities apply them.

(d) Improved explanations of the rationale (a) for some requirements and (b) for the conclusions in some illustrative examples. Improving those explanations should not change the way *any* entity accounts for the transactions addressed by those requirements and examples, because the requirements and example conclusions themselves would not change. However, improved explanations could help stakeholders better understand the principles underlying the requirements and conclusions—helping stakeholders judge the broader implications of the requirements and examples for other types of transactions.

This better understanding could make it easier for stakeholders to apply IAS 37 to new types of obligation that emerge from time to time—for example, as governments strengthen their climate-related regulations.

(e) Absorption of IFRIC Interpretations and IFRS Interpretations Committee agenda decisions.

Updates to the definition of a liability and the wording of the present obligation criterion

34. The staff suggest updating the definition of a liability in IAS 37 to align it with the new *Conceptual Framework* definition. IAS 37 is the only IFRS Accounting Standard that reproduces the old definition of a liability, so eliminating that old definition from IAS 37 would streamline IFRS requirements. In particular, it could help preparers of financial statements who are developing an accounting policy for a transaction that is not specifically addressed by any IFRS Accounting Standard. They would not need to make a judgement about which definition to apply.

35. We think that updating the definition would not change any of the requirements in IAS 37, or how they are applied. Although the new definition is clearer than the old one that an obligation can meet the definition of a liability even if a transfer of economic resources is unlikely, the 'probable outflows' recognition criterion in IAS 37 means that unless a transfer is probable, no provision would be recognised.

36. To avoid misunderstandings, we could add a discussion of obligations that are unlikely to require a transfer of economic resources with a cross reference to the probable outflows recognition criterion.

	Suggested changes	Staff notes	Drafting reference
(a)	Replace the existing definition of a liability in IAS 37 with the new *Conceptual Framework* definition.		**Appendix A** Amendments to definition in paragraph 10.
(b)	Amend the wording of the present obligation criterion to also to include 'to transfer an economic resource'.	The present obligation recognition criterion reinforces the requirement for a provision to meet the definition of a liability. Adding another aspect of the definition of a liability to the present obligation criterion does not change that requirement.	**Appendix A** Amendments to paragraph 14(a).
(c)	Remind readers that present obligations that are unlikely to require a transfer of resources are not recognised as provisions—cross refer to the 'probable outflows' recognition criterion.		**Appendix A** New paragraphs 16A and 16B.

Changes to some requirements supporting the present obligation recognition criterion

37. We think the only requirements that would change as a result of applying the *Conceptual Framework* are those relating to the timing of recognition of provisions (often levies) that are conditional on two or more actions of an entity. The change could be made by:

(a) replacing the existing requirements in paragraph 19 of IAS 37 and the consensus in IFRIC 21 with concepts from paragraphs 4.32, 4.43 and 4.44 in the *Conceptual Framework*; and

(b) changing the conclusions of the examples illustrating those requirements.

38. The staff suggest the following amendments to implement this change:

	Suggested changes	Staff notes	Drafting reference
(a)	Change requirements: (i) delete requirement for obligation to exist independently of entity's future actions (paragraph 19). (ii) withdraw IFRIC 21 and illustrative examples. (iii) replace with criteria for identifying a present obligation in paragraphs 4.32, 4.43 and 4.44 of the *Conceptual Framework.*	These amendments would change the timing of recognition of provisions as described in paragraph 27 of this paper.	**Appendix A** Deletion of paragraph 19 of IAS 37. Insertion of new paragraphs 14F, 19A and 19B.
(b)	Add four illustrative examples for levies, using the fact patterns of the four existing examples accompanying IFRIC 21.	These examples illustrate how the new requirements would lead to earlier (and progressive) recognition of some provisions for levies. There could be alternative views on how the new requirements would apply to the fourth example. This matter is discussed further in paragraphs 66-71 below.	**Appendix B** New examples 13A–13D.
(c)	Add a fifth illustrative example for levies.	A fifth example could be added to illustrate that, applying the new requirements, not all annual levies would necessarily be recognised progressively over a year. The example is based on a fact pattern similar to that found in several jurisdictions around the world.	**Appendix B** New example 13E.

Clarification of other requirements supporting the present obligation recognition criterion

39. The IASB could apply concepts in the *Conceptual Framework* to clarify several aspects of the requirements and guidance that give rise to questions in practice. Clarifications could include:

    (a) Untangling two criteria within the present obligation recognition criterion (paragraph 40);

    (b) Clarifying the meaning of 'can be enforced by law' (paragraphs 41–44);

    (c) Clarifying when commitments to reduce emissions to 'net zero' are present obligations (paragraphs 45–48).

Untangling two criteria within the present obligation recognition criterion

40. As explained in paragraph 30, the *Conceptual Framework* does not refer to, or define, an 'obligating event'. Instead, it separately identifies the two criteria for a present obligation, emphasising that both criteria must be met and discussing each one separately. Reorganising the IAS 37 requirements and guidance in the same way could clarify:

    (a) the need to satisfy two distinct criteria; and

    (b) the difference between the two criteria and the way in which they are assessed—satisfying the 'past events' criterion depends on timing facts; satisfying the 'no realistic alternative to settling' (or 'no practical ability' to avoid') criterion requires an enforceability assessment.

	Suggested clarifications	Staff notes	Drafting reference
(a)	Replace requirement for an 'obligating event' and definition of an obligating event with requirement to satisfy two criteria within that definition—the 'past event' criterion and the 'no realistic alternative to settling' criterion.	Applying the *Conceptual Framework* , the 'no realistic alternative to settling' criterion would be described using 'no practical ability to avoid' terminology.	**Appendix A** • Delete definition of the term 'obligating event' from paragraph 10 of IAS 37, and reference to the term from paragraph 17. (Note: paragraph 17 has been moved up to become paragraph 14D.) • Replace with new list of distinct criteria in paragraph 14A.
(b)	Reorganise the guidance explaining these two criteria into two separate sections.		**Appendix A** • New section entitled 'Obligation' (paragraphs 14B–16) contains paragraphs explaining the 'no practical ability to avoid' criterion. • Existing section 'Past event' (paragraphs 18-22) keeps the paragraphs explaining the past event criterion. NB: Paragraphs 17 and 20 need to be moved up from the 'Past event' section to the 'Obligation' section. They become paragraphs 14C–14E.

Clarifying the meaning of 'can be enforced by law'

41. Paragraph 17 of IAS 37 explains when an entity has no realistic alternative to settling a legal or a constructive obligation. For a legal obligation, it requires that 'settlement of the obligation can be enforced by law'.

42. As noted in paragraph 21(c), IAS 37 has no guidance on how to apply this requirement to situations in which a counterparty cannot use the courts to force an entity to comply with legal requirements, but can take other forms of action against entities that fail to comply, and the threat of that action might be sufficient to leave the entity with no practical ability to avoid complying.

43. The IFRS Interpretations Committee considered this question in reaching the conclusions in Agenda Decision *Negative Low Emission Vehicle Credits*. The Committee concluded that it is not necessary for the counterparty to be able to use the legal system to compel the entity to settle its obligation; it is sufficient that the counterparty has the legal right to take some form of action against an entity that fails to do so, and the consequences of that action are such that the entity is left with no realistic alternative to settling its obligation.

44. The IASB could add guidance consistent with this conclusion, perhaps also applying some of the *Conceptual Framework* discussion of the factors that might affect the assessment of an entity's realistic alternatives to settling (practical ability to avoid) an obligation. This discussion could cover the role of economic compulsion and obligations that could be avoided only by liquidating the entity (paragraphs 4.33 and 4.34 of the *Conceptual Framework*).

Suggested clarification	Drafting reference
Replace the term 'can be enforced by law' with expanded wording that reflects the Interpretation Committee's conclusions in its Agenda decision *Negative Low Emission Vehicle Credits*	**Appendix A** • Edits to paragraph 14D.

Clarifying when commitments to reduce emissions to 'net zero' are present obligations

45. Recently, stakeholders have been contacting us for views on how IAS 37 applies to various types of climate-related regulations and commitments. Stakeholders often ask when an entity should recognise obligations arising from a legal requirement or the entity's own public commitment to change its method of operation in the future—for example, to reduce its greenhouse gas emissions to 'net zero'.

46. Paragraph 4.45 of the *Conceptual Framework* provides concepts that help to answer that question. It states that:

> 4.45 If new legislation is enacted, a present obligation arises only when, as a consequence of obtaining economic benefits or taking an action to which that legislation applies, an entity will or may have to transfer an economic resource that it would not otherwise have had to transfer. The enactment of legislation is not in itself sufficient to give an entity a present obligation. Similarly, an entity's customary practice, published policy or specific statement … gives rise to a present obligation only when, as a consequence of obtaining economic benefits, or taking an action, to which that practice, policy or statement applies, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer.

47. This concept clarifies that a legal requirement or public commitment to offset future greenhouse gas emissions does not in itself give rise to a present obligation for an entity—an entity could have a present obligation for the costs of offsetting emissions only when it has emitted the gas it is required, or has promised, to offset. Before then, an entity would not recognise a provision, but might need to provide information about its commitments to comply with other reporting requirements or guidelines. For example, entities applying the forthcoming IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* would need to consider its requirement to disclose the current and anticipated financial effects of sustainability-related risks and opportunities.

48. The staff suggest adding to IAS 37 guidance based on paragraph 4.45 of the *Conceptual Framework* and an example illustrating how that guidance would apply to a commitment to reduce greenhouse gas emissions to net zero.

	Suggested clarifications	Staff notes	Drafting reference
(a)	Add guidance based on paragraph 4.45 to IAS 37.	A possible location is after paragraph 21 of IAS 37, which discusses the opposite situation—ie the introduction of a new law or public commitment that applies retrospectively to past events.	**Appendix A** • New paragraph 21A.
(b)	Add an example illustrating the guidance to the illustrative examples accompanying IAS 37.	A net zero commitment example can also note the need for judgement in assessing whether a public commitment is sufficient to create an obligation—ie whether it creates a valid expectation among other parties that the entity will adhere to its commitment.	**Appendix B** • New illustrative example: Example 15 Net Zero Commitment.

Improved explanations

49. Discussions with stakeholders have indicated to us that the implications of some application requirements and illustrative examples in IAS 37 are misunderstood. The implications are misunderstood because the reason for a requirement, or for the conclusion to an example, is explained imprecisely or incompletely.

50. The IASB could improve the explanations for some requirements and conclusions. Improved explanations would not change the outcome of applying IAS 37 to the transactions addressed by the requirements and examples, because the requirements and example conclusions would not themselves change. But improved explanations could clarify the underlying principles—thereby making it easier to judge whether and how to apply the requirement or example by analogy to transactions not specifically addressed in IAS 37.

51. We have identified two types of transactions for which we think improved explanations could assist with broader application of IAS 37:

    (a) restructuring provisions (paragraphs 52–56); and

    (b) obligations to exchange resources (paragraphs 57–64);

Restructuring provisions

52. Paragraphs 63–83 of IAS 37 explain how to apply the general recognition criteria to specific types of transactions. Paragraphs 70–83 discuss restructuring provisions, stating that 'a constructive obligation to restructure' arises when an entity has a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing is main features to those affected by it.

53. The wording of this requirement causes misunderstanding. It suggests that the existence of a formal plan for a future activity combined with a public announcement of that plan is sufficient to create a present obligation for the costs of that activity. Some people have applied the requirements for restructuring provisions to reach a view that entities should recognise the costs of achieving net zero emissions as soon as they have established and publicly announced a formal plan for doing so.

54. We think this is not the correct interpretation of IAS 37, and that misunderstandings could be avoided if the requirements for recognising restructuring provisions were better explained. We suggest that:

    (a) IAS 37 should not refer to an entity having a 'constructive obligation to restructure'. An entity does not have an obligation to restructure itself—unlike actions to reduce greenhouse gas emissions, a restructuring is a business activity implemented for the benefit of the entity, not for the benefit of other parties.

    (b) a more correct analysis is that:

        (i) entities may have responsibilities to pay specific costs *if* they restructure a business—for example, to pay redundancy costs to employees whose employment is terminated as part of the restructuring.

(ii) applying paragraph 4.32 of the *Conceptual Framework*, an entity has an obligation for any such costs if it has no practical ability to avoid the restructuring. Announcing or starting to implement a formal restructuring plan is evidence that an entity has no practical ability to avoid a restructuring and, hence, that it has an obligation for the costs necessarily entailed by the restructuring.

(iii) to the extent that the obligation arises as a result of past events, as defined in paragraph 4.43 of the *Conceptual Framework*—for example, as a result of obtaining employee services in the past—the entity has a present obligation for the costs. Paragraph 80 of IAS 37 ensures that only present obligations are included in a restructuring provision by restricting the costs to those that are 'not associated with the ongoing activities of the entity'.

(iv) the obligations included a restructuring provision could be legal (for example, obligations for statutory or contractual redundancy payments) or constructive (for example, obligations for additional redundancy payments management has agreed to make as part of its negotiations with employee representatives).

55. In other words, we think the existing requirements for recognition of restructuring provisions are consistent with the general recognition criteria in IAS 37—there is no need to amend the requirements themselves. However, we think the principles underlying the requirements would be clearer (and hence easier to apply by analogy) if some of the explanation supporting the requirements were refined.

56. Paragraph 81 lists examples of costs that are *not* included in a restructuring provision because they are associated with the ongoing activities of the entity. We suggest also adding some examples of costs that *would* be included to:

(a) reconcile the requirements to the 'past event' recognition criterion; and

(b) illustrate that the obligations included in a restructuring provision could be either legal or constructive.

	Suggested improvements to explanations	Drafting reference
(a)	Add a paragraph cross referencing from the restructuring requirements back to the applicable paragraph of the general recognition criteria.	**Appendix A** • New paragraph 72A.
(b)	Minor edits to delete the phrase 'obligation to restructure' and to avoid saying that the obligations included in a restructuring provision are necessarily constructive obligations.	**Appendix A** • Edits to paragraphs 72–76.
(c)	Addition of examples of restructuring obligations that arise from past events.	**Appendix A** • New paragraph 80A.
(c)	Amendments to analysis in illustrative examples on restructuring obligations.	**Appendix B** Examples 5A and 5B.

Obligations to exchange resources

57. In 2018, the IASB added to the *Conceptual Framework* concepts relating to executory contracts. Paragraph 4.57 of the *Conceptual Framework* states that:

(a) an executory contract establishes a combined right and obligation to exchange economic resources;

(b) the combined right and obligation constitute a single asset or liability; and

(c) an entity has an asset if the terms of the exchange are currently favourable, or a liability if the terms of the exchange are currently unfavourable.

58. Those concepts for obligations to exchange resources are implicit in the requirements of IAS 37:

(a) executory contracts are within the scope of IAS 37 only if they are onerous[2];

(b) IAS 37 requires an entity with an onerous contract to recognise a single liability[3], and

(c) three illustrative examples accompanying IAS 37 illustrate fact patterns in which involving potential exchanges of economic resources. The conclusion in each of these examples is that the entity does not recognise a provision.

59. The three examples illustrating potential exchanges of economic resources are:

(a) Example 6—which discusses new legislation requiring entities to fit smoke filters in factories.

(b) Example 11A—which discusses a furnace lining that has to be replaced every five years for technical reasons. The existing lining has been in use for three years.

(c) Example 11B—which discusses a legal requirement to overhaul aircraft every three years.

60. In all three examples, the conclusion is that no provision is recognised because no obligation exists independently of the entity's future actions. However, in examples 11A and 11B there has been a past event creating a possible requirement for future expenditure, and in all the examples, it can be assumed that the entity has no realistic alternative other than to incur that expenditure. The fact patterns (especially the fact pattern of example 11B) are similar to a fact pattern discussed in the IFRS Interpretation Committee's Agenda Decision *Negative Low Emission Vehicle Credits* Several respondents to the Committee's tentative agenda decision questioned the

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2 Paragraph 3 of IAS 37

3 Paragraph 66 of IAS 37.

tentative conclusion that a present obligation existed in that fact pattern—questioning how that conclusion could be reconciled to that in examples 6 and 11B.

61. In response, the staff prepared an analysis that sought to reconcile the conclusions, presenting it in Agenda Paper 4 (Appendix A) Negative Low Emission Vehicle Credits (IAS 37)—Supplementary Analysis—reconciliation to IFRIC 6, IFRIC 21 and Illustrative Examples 6 and 11B for the June 2022 meeting of the IFRS Interpretations Committee. That paper notes that all entities face constraints on the way they operate—for example, requirements to adhere to specified environmental, health and safety or social standards. It goes on to state that:

> A21 Such constraints do not necessarily give rise to liabilities because operating within a constraint does not necessarily require an outflow of economic resources. For example, to comply with environmental or health and safety regulations, an entity might need to purchase equipment (for example, smoke filters for its factories) or to enhance its existing equipment (for example, overhaul aircraft). In these cases, compliance does not require an outflow of economic resources—the entity exchanges one resource (cash) for another resource (equipment) and there is no net outflow. As illustrated in Illustrative Example 11B accompanying IAS 37, a requirement to overhaul aircraft every three years is accounted for by attributing part of the cost of an aircraft to components that need to be overhauled every three years, and depreciating that part of the cost over three years—not by recognising a provision for future overhaul costs.

62. In other words, even if obligations to fit smoke filters, replace furnace linings or overhaul aircraft arise from past events, they are not liabilities because they are not obligations to transfer an economic resource, they are obligations to exchange economic resources.

63. Committee members found this analysis helpful and at the request of one Committee member, we suggest incorporating a little of that analysis into Examples 6, 11A and 11B to help explain their conclusions.

64. Examples accompanying an IFRS Accounting Standard illustrate the requirements of the Standard. So, we suggest that, if the IASB refers to obligations to exchange resources in illustrative examples accompanying IAS 37, it also considers including a brief discussion of such obligations in IAS 37. This discussion could be based on the concepts for executory contracts in the *Conceptual Framework*.

	Suggested improvements to explanations	Staff notes	Drafting reference
(a)	Add to IAS 37 a statement that an obligation to exchange one economic resource for another economic resource is not an obligation to transfer an economic resource unless the terms of the exchange are unfavourable to the entity—for example, if the terms of an executory contract are onerous.	Based on paragraphs 4.39(c), 4.47 and 4.57 of the *Conceptual Framework*.	**Appendix A** • New paragraph 16C.
(b)	Refine the rationale for the conclusions to illustrative examples involving exchanges of economic resources.		**Appendix B** • Edits to the explanations for the conclusions in Illustrative examples 6, 11A and 11B.

Absorption of IFRIC Interpretations and IFRS Interpretations Committee agenda decisions

65. When the IASB amends an IFRS Accounting Standard it identifies IFRIC Interpretations and IFRS Interpretations Committee agenda decisions affected by the amendments and considers whether and how to reflect their conclusions in the amended Standard. In this case we suggest:

(a) withdrawing IFRIC 6, replacing it with a new illustrative example to accompany IAS 37. IFRIC 6 addresses a fact pattern that is narrow enough for an illustrative example. We think the consensus is consistent with the amended requirements and could be re-written as the conclusion to an illustrative example with only minor wording refinements.

(b) similarly, using the fact pattern and conclusions in Agenda Decision *Negative Low Emission Vehicle Credits* as the basis for another new illustrative example to accompany IAS 37. We think the conclusions would remain the same but that they would be simpler to explain following the changes and clarifications to IAS 37 suggested earlier in this paper.

(c) as discussed in paragraphs 37–38:

(i) withdrawing IFRIC 21 completely. Requirements for levies would be covered by the new general requirements and guidance.

(ii) using the illustrative examples accompanying IFRIC 21 as the basis for new illustrative examples to accompany IAS 37. The conclusions would change to reflect changes in the requirements of IAS 37.

	Suggested change	Drafting reference
(a)	Withdrawal of IFRIC 6, using the fact pattern and consensus as the basis for a new illustrative example.	**Appendix B** • New Example 12 Waste management costs.
(b)	Use of the fact pattern and conclusions of the agenda decision Negative Low Emission Vehicle Credits as the basis for a new illustrative example.	**Appendix B** • New Example 14 Negative low emission vehicle credits.
(c)	Withdrawal of IFRIC 21. Use of the fact patterns in the illustrative examples accompanying IFRIC 21 as the basis for new illustrative examples (with different conclusions).	**Appendix B** New Examples13A–13D.

Matters arising

Thresholds

66. As discussed in paragraphs 37–38, our suggestions include adding to the illustrative examples accompanying IAS 37 four new examples (Examples 13A–13D) with fact patterns based on those of the four illustrative examples currently accompanying IFRIC 21. The conclusions in these examples would be revised to reflect the changes to the requirements in IAS 37.

67. However, we have not suggested a conclusion for Example 13D, because we think two alterative conclusions could be reached applying requirements based on the *Conceptual Framework.* This example describes a fact pattern in which an entity is required to pay a levy if it generates revenue in excess of specified threshold in a calendar year. In one year, the entity's revenue reaches the threshold on 17 July. Applying the 'past event' criterion in the *Conceptual Framework*, it could perhaps be argued either:

    (a) that a present obligation arises only when the entity generates revenue *above* the threshold on which the levy starts to become payable, ie after 17 July; or

    (b) that a present obligation arises as an entity generates revenue as a consequence of which it might exceed the threshold (from the start of the year), if at that time management judges that the entity has no practical ability to avoid exceeding the threshold.

68. A different threshold-related question is raised by the fact pattern in the IFRS Interpretation Committee's Agenda Decision *Negative Low Emission Vehicle Credits* In this fact pattern, vehicle producers are required to transfer an economic resource if the *average* fuel emissions of the vehicles they produce in a calendar year exceeds a specified target. A question raised by this fact pattern was whether a producer that has produced vehicles with average fuel emissions *above* the target at an interim date has a present obligation at that date if management expects the average to have

dropped *below* the target by the end of the calendar year. We think the analysis in the agenda decision implies that the entity would have a present obligation at the interim date, but the conclusion in the agenda decision does not explicitly address this scenario.

69. Fact patterns involving payments triggered when a cumulative or average threshold is exceeded are relatively common. They arise not only with levies but also with a range of incentive-based laws and regulations, including some pollutant pricing mechanisms.

70. The IASB could consider developing application requirements to add to IAS 37. These requirements could provide a basis for the conclusions in the fourth levy example and could be of wider use to entities facing various types of threshold questions. In deciding whether to add requirements to IAS 37, the IASB would need to consider the possible implications of doing so for any future project to develop specific requirements for pollutant pricing mechanisms.[4]

71. The staff could prepare a more detailed analysis for the IASB to discuss at a future meeting.

The IASB project on Climate-related Risks in the Financial Statements

72. Following the Third Agenda Consultation, the IASB added to the maintenance project pipeline a narrow-scope project on Climate-related Risks in the Financial Statements. As part of that project, the IASB might consider whether and, if so, what further narrow-scope actions might be needed to improve the application of IAS 37 in relation to reporting such risks. Hence it is possible that, IASB members might revisit the discussions in this project as part of the climate-related risks project and discuss further suggestions for improvements to IAS 37.

[4] The IASB currently has a project on pollutant pricing mechanisms on its reserve list of projects that may be added to the work plan if additional capacity becomes available before the IASB's next five-yearly agenda consultation.

Next steps

73. We plan to update our suggestions in light of IASB members comments at this meeting. We suggest that our next step would then be to start consulting stakeholders. Our aims would be to familiarise stakeholders with our initial suggestions for possible amendments, and to obtain their views on those suggestions. We could use the feedback from stakeholders to identify any problems with, and opportunities to improve, the possible amendments before developing recommendations for the IASB to make tentative decisions on at a future IASB meeting.

74. Opportunities for consultation could include:

    (a) the June 2023 meeting of the IASB's Capital Markets Advisory Committee and Global Preparers Forum. That meeting will comprise a series of breakout sessions. Breakout groups could discuss examples illustrating the implications of some of the suggested amendments.

    (b) the July 2023 meeting of the IASB's Accounting Standards Advisory Forum.

    (c) the World Standard-setters Conference scheduled for September 2023. Examples illustrating some of the possible amendments could be a good discussion topic for breakout sessions at that conference.

Question for the IASB

Question for the IASB
Do you have any comments on or questions about the initial staff suggestions?