28 November 2024
Agenda Paper 6

UK Endorsement Board

Provisions – Targeted Improvements: Initial technical discussion

Executive Summary

Project Type	Influencing
Project Scope	Moderate

Purpose of the paper

On 12 November 2024 the IASB published the Exposure Draft IASB/ED/2024/8 *Provisions – Targeted Improvements* proposing amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

The IASB comment period closes on 12 March 2025.

The purpose of this paper is to provide an overview of the proposed amendments in the IASB's ED to facilitate an initial technical discussion.

Summary of the Issue

The main proposed amendments in the ED relate to the following aspects of IAS 37:

- when an entity recognises a provision;
- whether rates used to discount provisions reflect non-performance risk; and
- which costs to include in the measurement of a provision.

Some initial thoughts on potential implications are included for consideration.

Decisions for the Board

The Board is not asked to make any decisions but is invited to share views on any of the following:

- Do Board members have any comments or questions on the proposed amendments to the definition of a liability and/or the recognition criteria in IAS 37, as summarised in Appendix A?
- Do Board members have any comments or questions on the potential implications of the proposed amendments to the definition of a liability and/or the recognition criteria in IAS 37, as summarised in Appendix A?
- Do Board members have any comments or questions on the proposed amendments to the measurement requirements in IAS 37, as summarised in Appendix A?

• Do Board members have any comments or questions on the potential implications of the proposed amendments to the measurement requirements in IAS 37, as summarised in Appendix A? • Do Board members have any comments or questions on the transition requirements proposed by the IASB, as summarised in Appendix A? • Do Board members have comments or questions on any of the topics presented in Appendix B identified as requiring further consideration? Have Board members identified any additional aspects not currently presented in Appendix B?
Recommendation
Not applicable.
Appendices
Appendix A *Provisions – Targeted Improvements*: Overview of the proposed amendments Appendix B *Provisions – Targeted Improvements*: Topics for further consideration

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Provisions – Targeted Improvements

Purpose of the paper

1. At its October 2024 meeting, the Board approved the Project Initiation Plan for the influencing project *Provisions – Targeted Improvements*. As part of the approved approach and plan for the project, it was agreed that the Board would have the opportunity to have an initial technical discussion at its November 2024 meeting. The Secretariat intends to use this discussion to inform the UKEB Draft Comment Letter.

2. On 12 November 2024 the IASB published the Exposure Draft (ED) IASB/ED/2024/8 *Provisions - Targeted Improvements* proposing amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.* The IASB comment period closes on 12 March 2025.

3. The purpose of this paper is to present relevant information to the Board to facilitate its technical discussion. This paper summarises:

   a) An overview of key proposed amendments - Appendix A.

   b) Topics initially identified by the Secretariat as requiring further consideration - Appendix B.

4. In May[1] 2023, June[2] 2023, May[3] 2024, June[4] 2024 and July[5] 2024 the Board considered papers summarising the IASB discussions and tentative decisions on this project.

Next steps

5. The Secretariat aims to present a Draft Comment Letter for Board approval at the UKEB December 2024 meeting.

1 May 2023 IASB General Update: Appendix 6A.
2 June 2023 Agenda Paper 9 - Provisions – Targeted Improvements.
3 May 2024 IASB General Update: Appendix E.
4 June 2024 IASB General Update: Appendix A.
5 July 2024 IASB General Update: Appendix A.

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Appendix A: *Provisions – Targeted Improvements*: Overview of the proposed amendments

Background

A1. On 12 November 2024, the IASB published the Exposure Draft (ED) IASB/ED/2024/8 *Provisions - Targeted Improvements* proposing amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.* The IASB comment period closes on 12 March 2025.

A2. This paper presents an overview of key proposed amendments to facilitate an initial technical discussion. Consequential amendments to other IFRS Accounting Standards or minor amendments to IAS 37 are not covered in this paper.

Overview of key proposed amendments

Definition of a liability

A3. The IASB proposes to update the definition of a liability in IAS 37.10[1] to align it with the definition in the *Conceptual Framework for Financial Reporting* (the Conceptual Framework).

A4. As a result, a liability would be defined in IAS 37 as “a present obligation of the entity to transfer an economic resource as a result of past events”.

Provisions – recognition criteria

A5. The IASB proposes amendments to the first recognition criterion (the ‘present obligation recognition’ in IAS 37.14(a)) and second recognition criterion (the ‘probable outflow of resources criterion’ in IAS 37.14(b)). No amendments have been proposed to the third recognition criterion (the ‘reliable estimate criterion in IAS 37.14(c)).

[1] Technical references in this document presented as:
a) IAS 37.XX – represent a paragraph in the existing version of the Standard.
b) ED IAS 37.XX– represent a proposed paragraph in the Exposure Draft.

First criterion - Present obligation recognition criterion

A6. The IASB proposes a significant number of changes to the wording in the standard in relation to this criterion. Such proposals are briefly summarised in the following paragraphs.

A7. The present obligation recognition criterion is to be stated as "an entity has a present obligation (legal or constructive) to transfer an economic resource as a result of a past event" ('the present obligation recognition criterion').

A8. The proposed amendments also clarify that this criterion comprises the following three conditions [ED.IAS 37.14A]:

a) an obligation condition – the entity has an obligation;

b) a transfer condition – the nature of the entity's obligation is to transfer an economic resource; and

c) a past-event condition – the entity's obligation is a present obligation that exists as a result of a past event.

Obligation condition

A9. The IASB [ED.IAS 37.14B] proposes to specify that an entity has an obligation if:

a) a mechanism (legal or constructive) is in place that imposes a responsibility on the entity if it obtains specific economic benefits (such as goods or services) or takes a specific action (e.g. operates in a specific market or causes environmental damage or other harm to another party);

b) the entity owes that responsibility to another party; and

c) the entity has no practical ability to avoid discharging the responsibility if it obtains the specific economic benefits or takes the specific action.

A10. The IASB also proposes to specify that an entity *has no practical ability to avoid* discharging a responsibility [ED.IAS 37.14F]:

a) in the case of a legal obligation - if the other party has a legal right to act against the entity if the entity fails to discharge the responsibility and as a result of that right, the economic consequences for the entity of not discharging the responsibility are expected to be significantly worse than the costs of discharging it.

b) in the case of a constructive obligation - if the entity's pattern of past practice, published policy or sufficiently specific current statement creates valid expectations in other parties that the entity will discharge the responsibility.

Transfer condition

A11. To meet this condition, an obligation must have the potential to require the entity to transfer an economic resource to another party. For that potential to exist, it does not need to be certain or even likely. The probability does not affect whether an obligation meets the present obligation recognition criterion. The probability, however, affects the second recognition criterion, that is, the probable transfer of economic resources criterion (see paragraphs A19-A20 below). [ED.IAS 37.14I, 14J and 14K]

A12. The IASB proposes to clarify that an obligation to *exchange* economic resources with another party is not an obligation to transfer an economic resource to that party, unless the terms of the exchange are unfavourable to the entity. Accordingly, the obligations arising under an executory contract[2] - for example, a contract to receive goods in exchange for paying cash - are not obligations to transfer an economic resource unless the contract is onerous[3]. [ED.IAS 37.14L]

Past-event condition

A13. An entity's obligation becomes a present obligation that exists as a result of a past event when the entity [ED.IAS 37.14N]:

a) has obtained specific economic benefits or taken a specific action; and

b) as a consequence of having obtained those benefits or taken that action, will or may have to transfer an economic resource it would not otherwise have had to transfer.

A14. If the economic benefits are obtained or the action is taken, over time, the past-event condition is met and the resulting present obligation accumulates over that time. [ED.IAS 37.14O]

Obligations to transfer an economic resource only if an entity takes two (or more) separate actions and the requirement to transfer an economic resource is a consequence of taking both (or all) these actions

A15. For this type of obligation, the past-event condition is met when the entity has taken the first action (or any of the actions) and *has no practical ability to avoid* taking the second action (or all the remaining actions). [ED.IAS 37.14Q]

A16. The ED notes that a decision to prepare an entity's financial statements on a going concern basis implies that the entity has no practical ability to avoid taking an

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2 The ED proposes to align the definition of 'executory contract' in IAS 37 with that in the Conceptual Framework, that is, "an executory contract is a contract, or a portion of a contract, that is equally unperformed – neither party has fulfilled any of its obligations, or both parties have partially fulfilled their obligations to an equal extent."

3 IAS 37 paragraph 10 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.

action it could avoid only by liquidating the entity or by ceasing to trade. [ED.IAS 37.14R]

Obligations to transfer an economic resource only if a measure of an entity's activity in a period (the assessment period) exceeds a specific threshold (threshold-triggered costs)

A17. For this type of obligation, the action that meets the past-event condition is the activity that contributes to the total activity on which the amount of the transfer is assessed. At any date within the assessment period, the present obligation is a portion of the total expected obligation for the assessment period, that is, the portion attributable to the activity carried out to date. [ED.IAS 37.14P]

Interactions between the obligation and past-event conditions

A18. The ED notes that the enactment of a new law is not sufficient to create a present legal obligation for an entity. Similarly, having an established pattern of past practice, publishing a policy or making a statement is not in itself sufficient to create a present constructive obligation for an entity. A present obligation arises only if, as a consequence of obtaining the economic benefits or of taking the action to which the law or constructive obligation applies, the entity will (or may) have to transfer an economic resource it would not otherwise have had to transfer. [ED.IAS 37.14S and 14T]

Second criterion - Probable outflow of resources criterion

A19. The ED proposes to amend the probable outflow of resources criterion to read as follows: "it is probable that the entity will be required to transfer an economic resource to settle the obligation". [ED.IAS 37.14(b)]

A20. The proposed amendment brings consistency with ED.IAS 37.14A(b) by also explicitly introducing the concept of 'transfer of economic resources'.

Third criterion – Reliable estimate criterion

A21. No amendments have been proposed to the third recognition criterion.

Withdrawal of certain IFRIC Interpretations and Agenda Decisions

A22. The IASB proposals include withdrawing IFRIC 6 *Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment* and IFRIC 21 *Levies*. Those will be replaced with illustrative examples in the *Guidance on implementing IAS 37*.

A23. The *Guidance on implementing IAS 37* will also be amended by adding examples to illustrate fact patterns that have been the subject of IFRS Interpretations Committee agenda decisions, as well as by expanding the decision tree and updating the analyses in existing illustrative examples to align them with the proposed requirements.

Potential implications

A24. The proposed amendments to the present obligation recognition criterion would have widespread applicability. This criterion affects decisions about whether and when to recognise all types of provisions. Entities that are subject to levies and similar government-imposed charges are among those that are likely to be most significantly affected by the proposed amendments.

A25. The proposed removal of the obligating event definition and the introduction of three conditions (i.e. obligation, transfer and past event) to the present obligation recognition criterion could be perceived as welcome improvements as those provide a more robust structure to the technical analysis and enhances the clarity of the recognition requirements.

A26. Clarity is also enhanced by the IASB's proposed amendments to the illustrative examples in the *Guidance on implementing IAS 37,* as all illustrative examples now follow a similar structure analysing separately each of the three conditions. The revised structure facilitates comparison of the technical analysis for the different fact patterns.

A27. There are, however, specific areas in the proposals that require close consideration and analysis. [Refer to Appendix B]

Questions for the Board
1. Do Board members have any comments or questions on the proposed amendments to the definition of a liability and/or the recognition criteria in IAS 37?
2. Do Board members have any comments or questions on the potential implications of the proposed amendments to the definition of a liability and/or the recognition criteria in IAS 37?

Measurement – Expenditure required to settle an obligation

A28. The proposals aim to clarify that the expenditure required to settle an obligation comprises the costs that relate directly to the obligation. Costs that relate directly to an obligation consist of both [ED.IAS 37.40A]:

a) the incremental costs of settling that obligation; and

b) an allocation of other costs that relate directly to settling obligations of that type.

Potential implications

A29. The IASB proposals would apply to the measurement of any type of provision within the scope of IAS 37. However, as part of initial stakeholder engagement question have been raised in relation the application of the proposed amendment to certain obligations. [Refer to Appendix B]

Measurement – Discount rates

A30. The amendments specify that in discounting a long-term provision, an entity uses a discount rate that reflects the time value of money, represented by a risk-free rate, with no adjustment for non-performance risk. [ED.IAS 37.47(a) and 47A].

A31. If a provision is discounted, an entity will be required to disclose, by class of provision, the discount rate(s) used in measuring the provision and the approach used to determine such rate(s). [ED.IAS 37.85(d)]

Potential implications

A32. The IASB proposals on discount rates could be perceived as limited changes to the wording in IAS 37, however, the effect on the amount of a provision accounted for on an entity's balance sheet could be significant for those entities with long-term obligations currently measured at present value by using a discount rate adjusted for non-performance risk.

A33. The IASB considers that the entities most affected by the proposals are likely to be those with large long-term asset decommissioning or environmental rehabilitation provisions, typically entities operating in the energy generation, oil and gas, mining and telecommunication sectors.

A34. Refer to Appendix B for initial stakeholder feedback in relation to the proposed disclosure requirement.

Questions for the Board
3. Do Board members have any comments or questions on the proposed amendments to the measurement requirements in IAS 37? 4. Do Board members have any comments or questions on the potential implications of the proposed amendments to the measurement requirements in IAS 37?

Transition requirements

A35. An entity will be required to apply the amendments retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except:

a) If an entity changes its accounting policy for the costs it includes in the measurement of a provision the entity will be **required** to apply the change in accounting policy only to obligations the entity has not yet settled at the *date of initial application*[4] of the amendments and without restating comparative information. [ED.IAS 37.94D]

This proposal is consistent with the transitional provision required for the amendment '*Onerous Contracts – Cost of Fulfilling a Contract*' issued in May 2020 [IAS 37.94A].

b) If an entity changes its accounting policy for determining discount rates, the entity **is not required** to comply with the requirements in IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* for changes in the measurement of a provision that occurred before the *transition date*[5]. [ED.IAS 37.94E] An entity that uses this exemption is required:

i. to apply the amended requirements to restate the provision at the transition date; and

ii. apportion the amount by which it adjusts the provision at the transition date between the related asset and retained earnings. This is performed assuming the current discount rate(s) and estimates of cash flows used in measuring the provision have not changed since the provision was first recognised and using current estimates of the useful life of the related asset.

Although not authoritative, an illustrative example of the proposed transition requirements for discount rates was presented in the Appendix to June 2024 IASB Staff agenda paper 22B (pages 17 to 21). The exception, although complex, is meant to be less onerous for entities than applying the amendments to discount rates fully retrospectively.

This proposal is similar to that already provided for first-time adopters of IFRS Accounting Standards by IFRS 1 paragraph D21.

4 The *date of initial application* is the beginning of the annual reporting period in which the entity first applies the amendments.

5 The *transition date* is the beginning of the first annual reporting period for which the entity provides comparative information.

Questions for the Board	
5.	Do Board members have any comments or questions on the transition requirements proposed by the IASB?

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Appendix B: *Provisions – Targeted Improvements*: Topics for further consideration

Background

B1. The UKEB Secretariat is in the process of assessing the proposals in the Exposure Draft (ED) IASB/ED/2024/8 *Provisions - Targeted Improvements*.

B2. The Secretariat has currently identified certain topics where further consideration is needed. Work is ongoing and further topics might need to be added to the list below.

B3. Board members are not asked to make any decisions at this meeting but are invited to share views on any of the following topics.

Proposed amendments – topics for further consideration

Present obligation recognition criterion

No practical ability to avoid test

B4. An assessment of whether an entity has '*no practical ability to avoid*' discharging a responsibility [Appendix A – A10] is an area where judgement may need to be applied.

B5. The use of judgement in the application of IFRS Accounting Standards is not unique to IAS 37 and does not necessarily indicate a deficiency in a standard. The question, therefore, is whether the proposal is sufficiently clear so that this concept can be applied consistently.

Transfer/exchange of economic resources

B6. The ED introduces an explicit distinction between a *transfer* and an *exchange* of economic resources [Appendix A – A11-A12]. The IASB considers the proposals reflect current requirements and practice. Initial feedback to date suggests that the distinction between transfer and exchange may not always be clear cut. As part of our public consultation and further stakeholder engagement we will consider this further.

Withdrawal of IFRIC 21 / past event condition

B7. For straightforward scenarios, the proposed amendments to the present obligation recognition criterion do not appear to present any particular difficulties. The conclusion is not so clear when applied to more complex fact patterns, such as certain bank levies, where an entity would need to consider the proposed requirements for obligations to transfer an economic resource **only if an entity takes two (or more) separate actions** [Appendix A – A15-A16].

B8. We understand that the identification of the relevant action(s) is not a question of management's judgement but based on the relevant 'mechanism' imposing the responsibility on the entity. For example, it could be the terms and conditions of a contract or, in the case of a levy, such a mechanism would be the corresponding legislation.

B9. Further consideration (and testing of the proposals) is needed to identify whether the requirements can be applied consistently across different fact patterns and whether they lead to a sensible accounting outcome. This is also applicable to the proposed requirements on **threshold-triggered costs** [Appendix A – A17].

B10. In withdrawing IFRIC 21 the proposed amendments would be applicable to ***all*** obligations in the scope of IAS 37, not only levies. The risk of unintended consequences needs to be considered.

B11. Note that the past event condition also includes a 'no practical ability to avoid' test. This arises when two or more actions are needed to trigger the transfer of an economic resource. Here, however, the issue appears to relate not to the strength of the mechanism, but to the realistic options available to management. There are therefore two subtly different 'no practical ability to avoid' tests.

Application of the recognition and measurement rules - Restructuring

B12. The IASB has proposed only limited editorial amendments to the section in IAS 37 'Application of the recognition and measurement rules – Restructuring'. [ED.IAS 37.70-81].

B13. Some of those requirements could potentially be more helpful if they followed the proposed new structure for the assessment proposed in the revised illustrative examples (i.e. disaggregating by obligation, transfer, past-event, etc). Consideration will need to be given to whether, as it stands, some of the restructuring guidance could be perceived as confusing or inconsistent with the IASB's current proposals.

Measurement – Expenditure required to settle an obligation

B14. As part of our initial stakeholder engagement, questions have been raised as to how the proposed amendment should be applied to certain obligations not settled

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by the provision of goods or services, such as legal claims. Further consideration will need to be given to the implications of this amendment.

Measurement – Discount rates

B15. As part of our initial stakeholder engagement concerns have been raised by preparers about the proposed requirement to disclose the discount rate(s) used, by class of provision, noting that entities could use a large number of discount rates for a single class of provision (varying for example by currency or tenor). Stakeholders questioned the usefulness of disclosing such a range of discount rates. The Secretariat will aim to engage with users of accounts to assess their information needs and the usefulness of the proposed new disclosure.

Question for the Board	
6.	Do Board members have comments or questions on any of the topics identified as requiring further consideration? Have Board members identified any additional aspects not currently presented in this Appendix?