IFRS Foundation

World Standard-setters Conference 2024

Provisions—Targeted Improvements

A preview of the forthcoming Exposure Draft

#WSS2024

Presenters

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Agenda

1. Project overview
2. Proposed amendments—present obligation recognition criterion
3. Proposed amendments—measurement requirements
4. Questions?

Project overview

Project aims and plans

IFRS Accounting Maintenance Project

Provisions—Targeted Improvements

Amendments to
IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Exposure Draft expected Q4 2024

Three aspects of IAS 37 targeted for improvement

Recognition	Measurement	Measurement
‘Present obligation’ recognition criterion	Estimates of expenditure required to settle provision — costs to include	Rates used to discount future expenditure to present value

Proposed amendments—present obligation recognition criterion

IAS 37 criteria for recognising a provision

1 Present obligation as a result of a past event	2 Probable outflow of resources	3 Reliable estimate

‘Obligating event’

- A past event that leads to a present obligation
- An event that creates an obligation that results in entity having no realistic alternative to settling that obligation

Legal obligation

- Settlement ‘can be enforced by law’

Problems with present obligation criterion in IAS 37

Requirements unclear

- obligating event definition mixes two conditions
- obligation condition difficult to apply to some newer regulations, eg climate-related regulations
  - enforced via economic incentives
  - offering novel settlement options

Requests to IFRS Interpretations Committee

- IFRIC 6 and IFRIC 21
- Agenda Decision *Negative Low Emission Vehicle Credits*

Outcomes unsatisfactory—obligations for annual levies recognised late and at point in time

Investor requests for more useful information

Proposals to improve present obligation criterion

Applying *Conceptual Framework*

1. Update liability definition and wording of recognition criterion
2. Disentangle supporting requirements
3. Clarify obligation condition
4. Amend past-event condition
5. Add requirements for threshold-triggered costs
6. Update *Guidance on implementing IAS 37*

1 Update liability definition and wording of recognition criterion

	IAS 37 wording	Proposed wording
Liability definition	Present obligation arising from past events, settlement of which is expected to result in outflow of resources embodying economic benefits	Present obligation to transfer an economic resource as a result of past events
Present obligation recognition criterion	Entity has a present obligation (legal or constructive) as a result of a past event	Entity has a present obligation (legal or constructive) to transfer an economic resource as a result of a past event

2 Disentangle supporting requirements

IAS 37 now	Proposal		
An obligating event has occurred	**Obligation condition** The entity has an obligation	**Transfer condition** The nature of the obligation is to transfer an economic resource	**Past-event condition** The obligation is a present obligation that exists as a result of a past event

Exchange ≠ transfer (unless unfavourable)

3 Clarify obligation condition

An entity has an obligation if

a) a mechanism imposes a responsibility on the entity if it obtains specific benefits or takes a specific action

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 benefits or takes the action**

Mechanism could be legal or constructive

No practical ability to avoid discharging = no realistic alternative to settling

3 Clarify 'no practical ability to avoid'

	IAS 37 now		Proposal
Legal obligation	Settlement can be enforced by law	→	Other party has legal right to take action against entity if it fails to settle obligation As a result, economic consequences of not settling are significantly more adverse than those of settling
Constructive obligation	Entity's past practice, policy or statement creates valid expectation in other parties that entity will settle obligation	=	[No change]

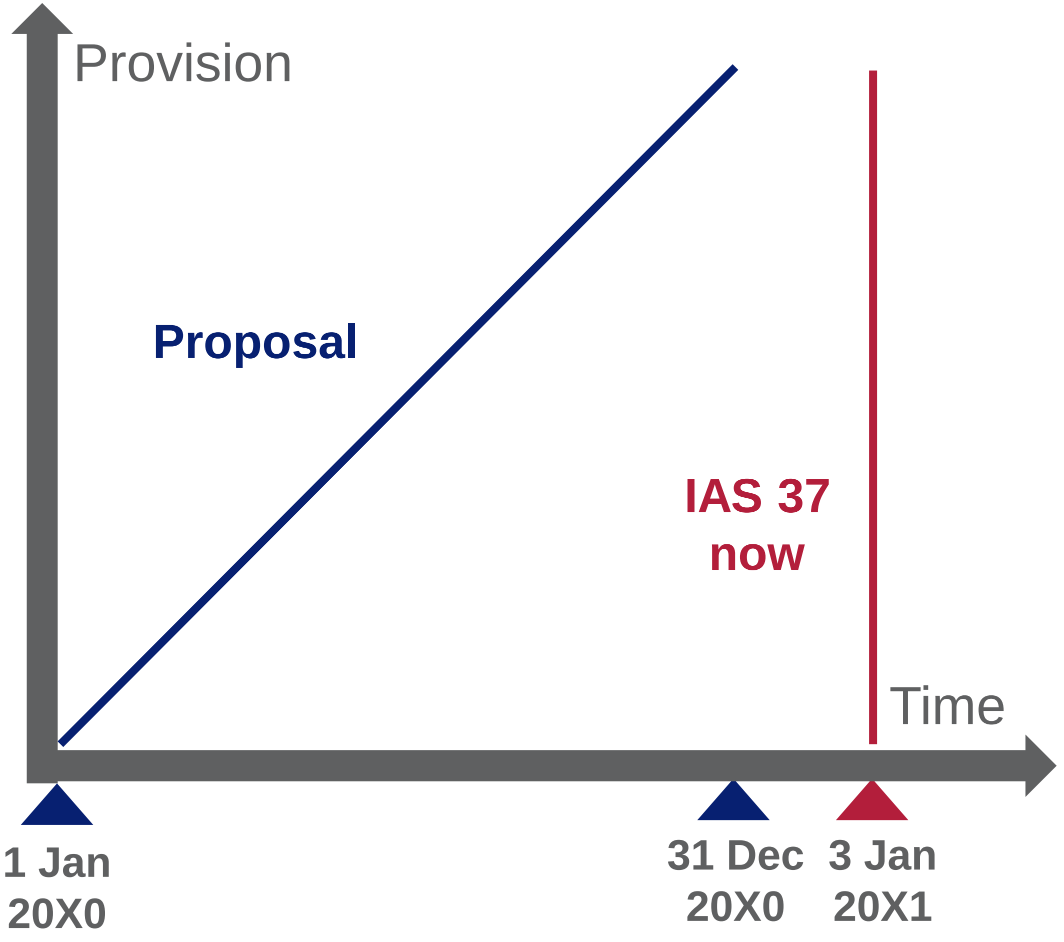
4 Amend past-event condition

IAS 37 now	Proposal	
Paragraph 19 of IAS 37 Obligation exists independently of entity's future actions + **IFRIC 21 *Levies*** Obligating event is event that triggers payment of levy	○ Entity has obtained the specific economic benefits or taken the specific action, and ○ as a consequence, will or may have to transfer an economic resource it would not otherwise have had to transfer	Two separate actions required? ↓ Entity must have taken first action and have no practical ability to avoid remaining actions

4 Implications of amendments to past-event condition

- Levy triggered when entity generates revenue in a market in 20X1
- Levy is 1% of revenue generated in 20X0
- Entity generates revenue evenly throughout 20X0, and in 20X1 starts to generate revenue on 3 January 20X1
- Throughout 20X0, management judges entity has no practical ability to exit market before 20X1

Two separate actions of entity:
1. Generate revenue in 20X0
2. Start to generate revenue in 20X1



5 Add requirements for threshold-triggered costs

Costs payable if a measure of entity's activity in a period exceeds a specific threshold

Examples

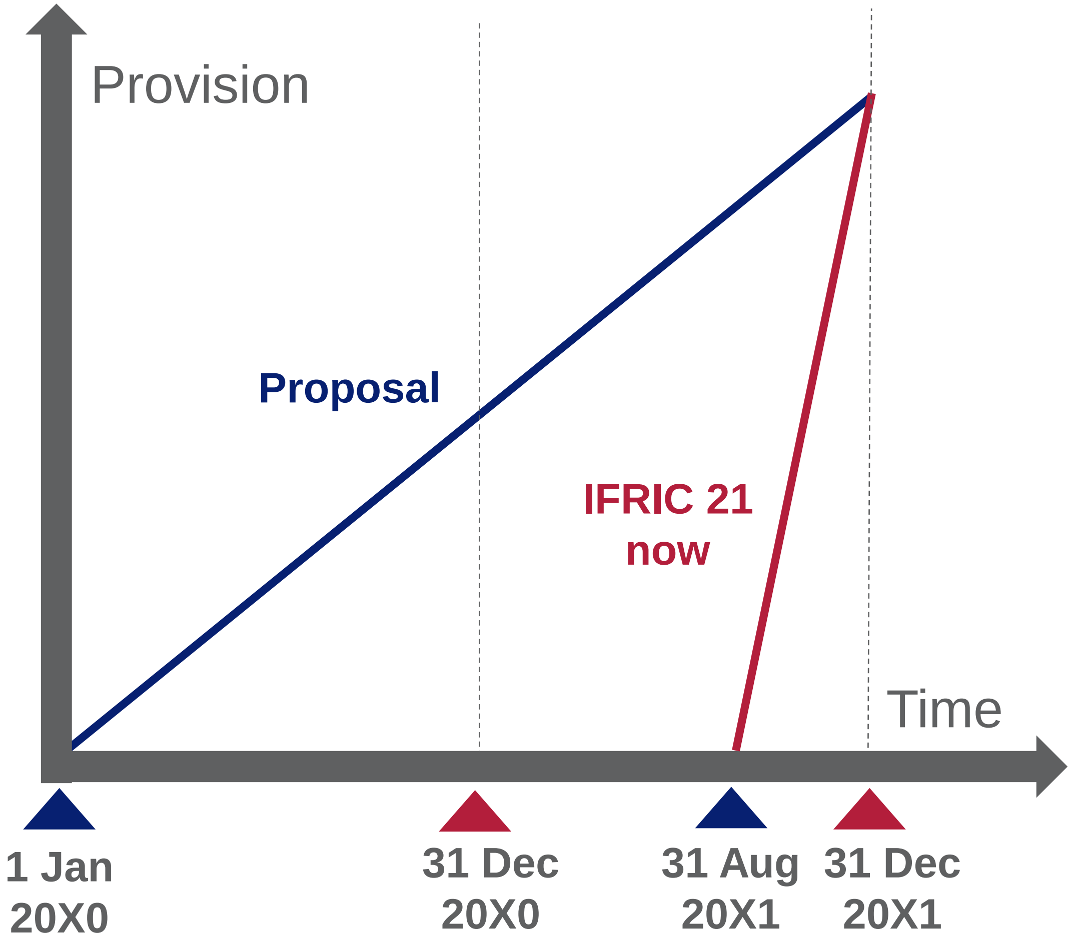
- Levy payable by entity whose annual revenue exceeds specified amount
- Maintenance costs lessee pays if condition of leased asset at end of lease falls below specified threshold
- Penalties imposed on entity whose greenhouse gas emissions in specified period exceed allocated quota

5 Add requirements for threshold-triggered costs

IAS 37 now	Proposal
IFRIC 21 Example 4 • Obligating event is activity above threshold	• Present obligation accumulates as entity conducts activity that contributes to total on which cost is calculated • Present obligation is portion of total expected obligation—the portion attributable to activity to date • Provision is recognised if other recognition criteria are met: 1. probable transfer—ie probable that activity will exceed threshold, and 2. amount can be reliably estimated

5 Implications of requirements for threshold-triggered costs

- Levy payable if revenue exceeds CU200 million in two-year period—1 Jan 20X0 to 31 Dec 20X1
- Levy = 1% of revenue above threshold
- Management forecasts revenue of CU10 million / month (CU240 million in 2-year period)
- Actual revenue equals forecast—crossing threshold on 31 August 20X1



6 Update *Guidance on implementing IAS 37*

1. Update and expand decision tree

2. Add new illustrative examples

Based on fact patterns of

- IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment*
- Various levies, including some like those in examples accompanying IFRIC 21
- Agenda Decision *Negative Low Emission Vehicle Credits*
- Agenda Decision *Climate-related Commitments*

Proposed amendments—measurement requirements

Measurement 1—Costs to include

IAS 37 now	Proposed clarification
Measure provision at best estimate of expenditure required to settle present obligation	Expenditure = costs that 'relate directly' to obligation **Incremental** costs of settling that obligation + **Allocation** of other costs that relate directly to settling obligations of that type

Measurement 2—Discount rates

IAS 37 now	Proposed requirements
Discount expenditure at a rate that reflects: ○ time value of money, and ○ risks 'specific to the liability' (excluding risks reflected in cash flows)	Discount expenditure at a rate that reflects: ○ time value of money **as represented by a risk-free rate,** and ○ **risks in expenditure required to settle obligation** if not reflected in estimates of cash flows, but ○ **<u>not</u> non-performance risk** **Disclose** rates used and approach used to determine rates

Questions?

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