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## Accounting Standards Advisory Forum meeting

Date	<b>July 2023</b>
Project	<b>Provisions—Targeted Improvements</b>
Topic	<b>Present obligation recognition criterion</b>
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# Purpose of this session

To hear ASAF members' views on:

1. initial suggestions for possible amendments to the requirements and illustrative examples supporting the 'present obligation' recognition criterion in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.
2. whether to add to IAS 37 application requirements specifying when an entity has a present obligation for costs payable if a measure of its activity—for example, its revenue or carbon emissions—exceeds a specified threshold.
3. what guidance, if any, to include in IAS 37 on the meaning of 'no practical ability to avoid'.

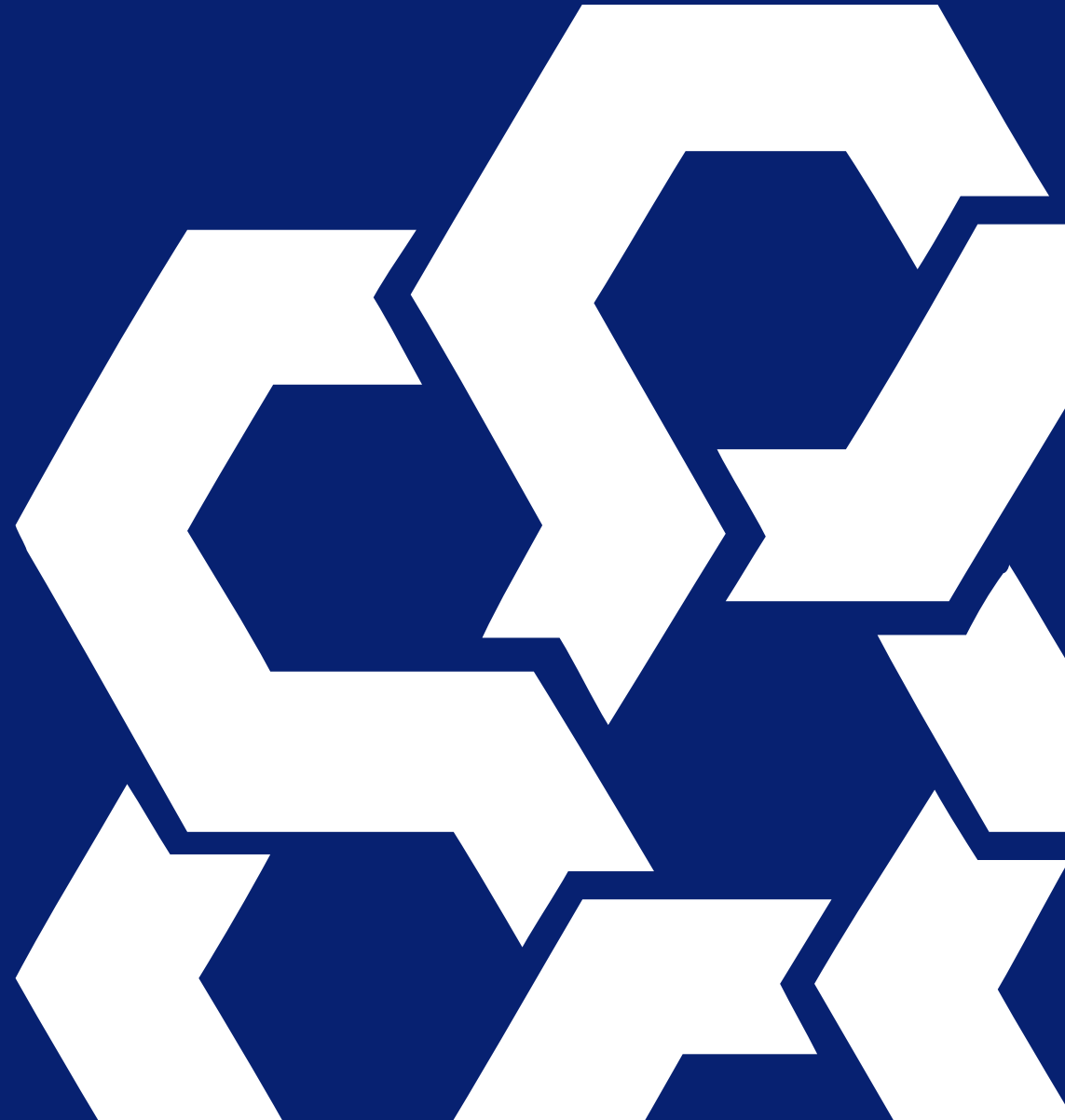
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# Contents

	<b>Slide</b>
Questions for ASAF members	5
Topic 1—Initial suggestions for possible amendments to IAS 37	6–9
Topic 2—Thresholds	10–13
Topic 3—Guidance on meaning of ‘no practical ability to avoid’	14–16

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# Questions for ASAF members



# Questions for ASAF members

**1**

## Initial suggestions for possible amendments

- a) What are your overall reactions to the possible amendments to IAS 37 suggested in Agenda Paper 6A?  
See slides 7–9.
- b) Do you have specific comments on any aspects of the possible amendments? \*

**2**

## Thresholds

- a) Should IAS 37 specify when an entity has a present obligation for costs payable if a measure of its activity exceeds a specified threshold? See slide 11.
- b) Do you have views on when the present obligation arises? See slides 12–13.

**3**

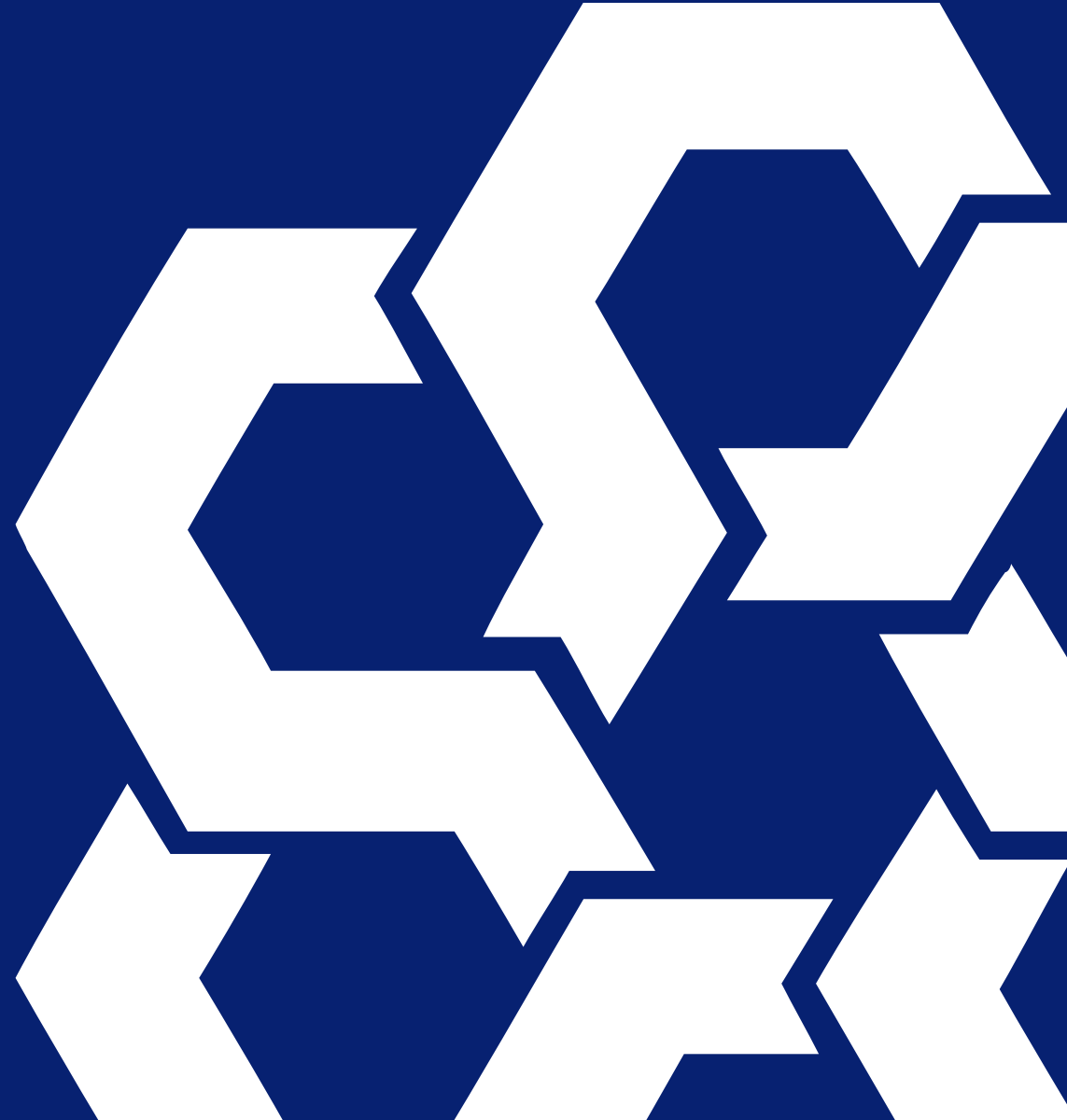
## Guidance on meaning of ‘no practical ability to avoid’

- a) Do you think IAS 37 should include guidance on the meaning of ‘no practical ability to avoid’.
  - b) Should IAS 37 retain the requirement that settlement of a legal obligation ‘can be enforced by law’?
  - c) What, if any, role should economic compulsion play in assessing an entity’s practical ability to avoid an obligation?
- See slides 15–16.

\* We do not expect you to have reviewed in detail the illustrative drafting in the appendices to Agenda Paper 6A. We have included this illustrative drafting just to help you understand the nature and extent of the possible amendments discussed in Agenda Paper 6A.

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## Topic 1—Initial suggestions for possible amendments to IAS 37



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# Background

- The IASB is undertaking a project to make three targeted improvements to IAS 37.
- One of these improvements would affect a criterion for recognising a provision in the financial statements—specifically, the requirement for an entity to have a present obligation as a result of a past event.\*
- The IASB is considering amending the requirements supporting that recognition criterion, with the aim of:
  - clarifying the requirements—making them easier to apply and promoting consistent application; and
  - changing the timing of recognition of some provisions—specifically provisions for costs (often levies) that are triggered only if the entity takes both (or all) of two (or more) actions.
- The IASB has already developed concepts on which to base new requirements—it added those concepts to its *Conceptual Framework* in 2018. The amendments to IAS 37 would involve importing the concepts into IAS 37 (to replace existing requirements), withdrawing IFRIC 21 *Levies* and updating some of the illustrative examples accompanying IAS 37.

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\* Paragraph 14(a) of IAS 37

## Current status of amendments and IASB plans

- IASB discussed initial suggestions for possible amendments at meeting in April 2023
- No decisions requested

IASB now consulting stakeholders

- Tentative decisions at future meeting\*
- Any proposed amendments would be exposed for comment

\* Currently expected in Q4 2023



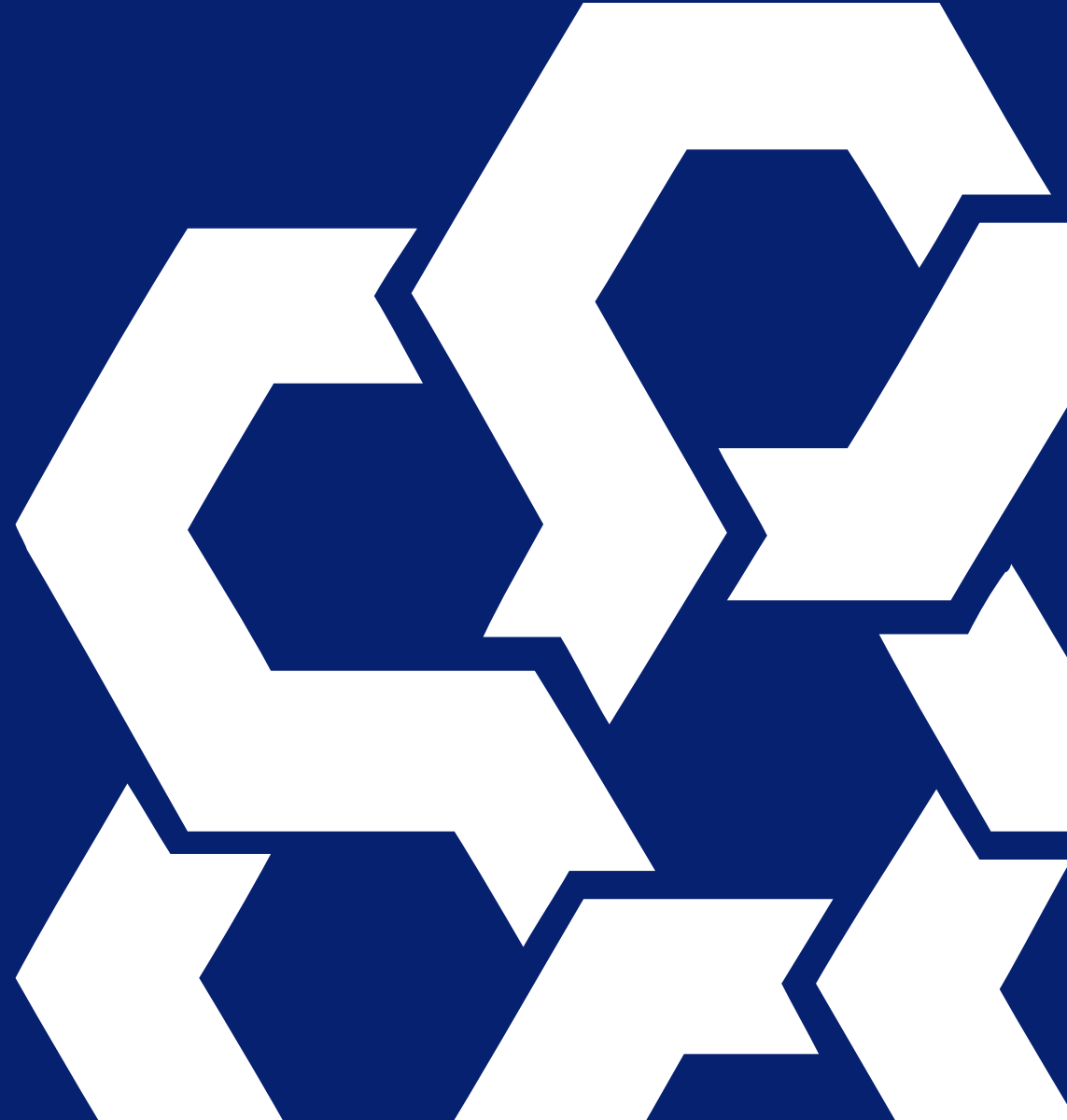
# Initial suggestions for possible amendments

Initial suggestions for possible amendments are set out in a staff paper discussed by the IASB at its April 2023 meeting. That paper, which has two appendices, is reproduced as Agenda Paper 6A for this meeting.

ASAF Agenda Ref	Paper contents
6A	An explanation of: <ul style="list-style-type: none"> <li>• reasons for amending requirements supporting the present obligation recognition criterion.</li> <li>• progress the IASB has already made towards developing possible amendments—revisions to its <i>Conceptual Framework for Financial Reporting</i> in 2018.</li> <li>• suggestions for possible amendments to IAS 37 and to the illustrative examples accompanying IAS 37.</li> </ul>
6A (Appendix A)	Illustrative drafting for the possible amendments to IAS 37.
6A (Appendix B)	Illustrative drafting for the possible amendments to illustrative examples accompanying IAS 37—including for the addition of new examples on levies (Examples 13A-E), climate-related legislation (Example 14) and a net zero commitment (Example 15).

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## Topic 2—Thresholds



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## Thresholds—whether there is a need for application requirements

As discussed further in paragraphs 66–71 of Agenda Paper 6A, questions sometimes arise about when an entity has a present obligation for costs that become payable only if a measure of its activity exceeds a specified threshold. The IASB could consider adding to IAS 37 specific application requirements for such circumstances.



### Examples

- Sector levies on entities with revenues exceeding a specified annual value.
- Penalties for greenhouse gas emissions above a specified amount.

Thresholds might be measures of the entity's cumulative or average activity.



### Factors to consider in assessing the need for application requirements

- Prevalence—are such obligations widespread in practice?
- Are the amounts large enough for information about the obligations to be material?
- Are specific requirements necessary to avoid diversity in practice (might different views be reached applying the general requirements—see slide 12)?

## Thresholds—potentially applicable requirements

The drafting suggestions in Agenda Paper 6A (Appendix A) include requirements specifying when an entity has a present obligation as a result of a past event. Several of those requirements might be applicable to provisions for costs payable if a measure of an entity’s activity exceeds a specified threshold:

Paragraph	Suggested drafting
19A	An entity has a present obligation as a result of a past event only if the entity: <ul style="list-style-type: none"> <li>a) has obtained economic benefits or taken an action; and</li> <li>b) as a consequence, will or may have to transfer an economic resource it would not otherwise have had to transfer.</li> </ul>
19B	... If economic benefits are obtained, or an action is taken, over time, the resulting present obligation may accumulate over that time.
14F	In some situations, an entity’s responsibility to transfer an economic resource arises from past events (as described in paragraph 19A) but is conditional on a particular future action that the entity itself may take. ... In such situations, the entity has an obligation if it has no practical ability to avoid taking that action.

## Thresholds—possible views on how the general requirements apply

1. The ‘action’ that creates a present obligation is activity above the threshold—no present obligation exists until the entity’s activity has exceeded the threshold **or**

→ Provision recognised later

2. The ‘action’ that creates a present obligation is the activity to which the charge applies—for example, the generation of revenue, or the emission of greenhouse gases. A present obligation starts to accumulate as soon as the entity starts to perform the activity:

→ Provision recognised earlier

A. if it has no practical ability to avoid exceeding the threshold **or**

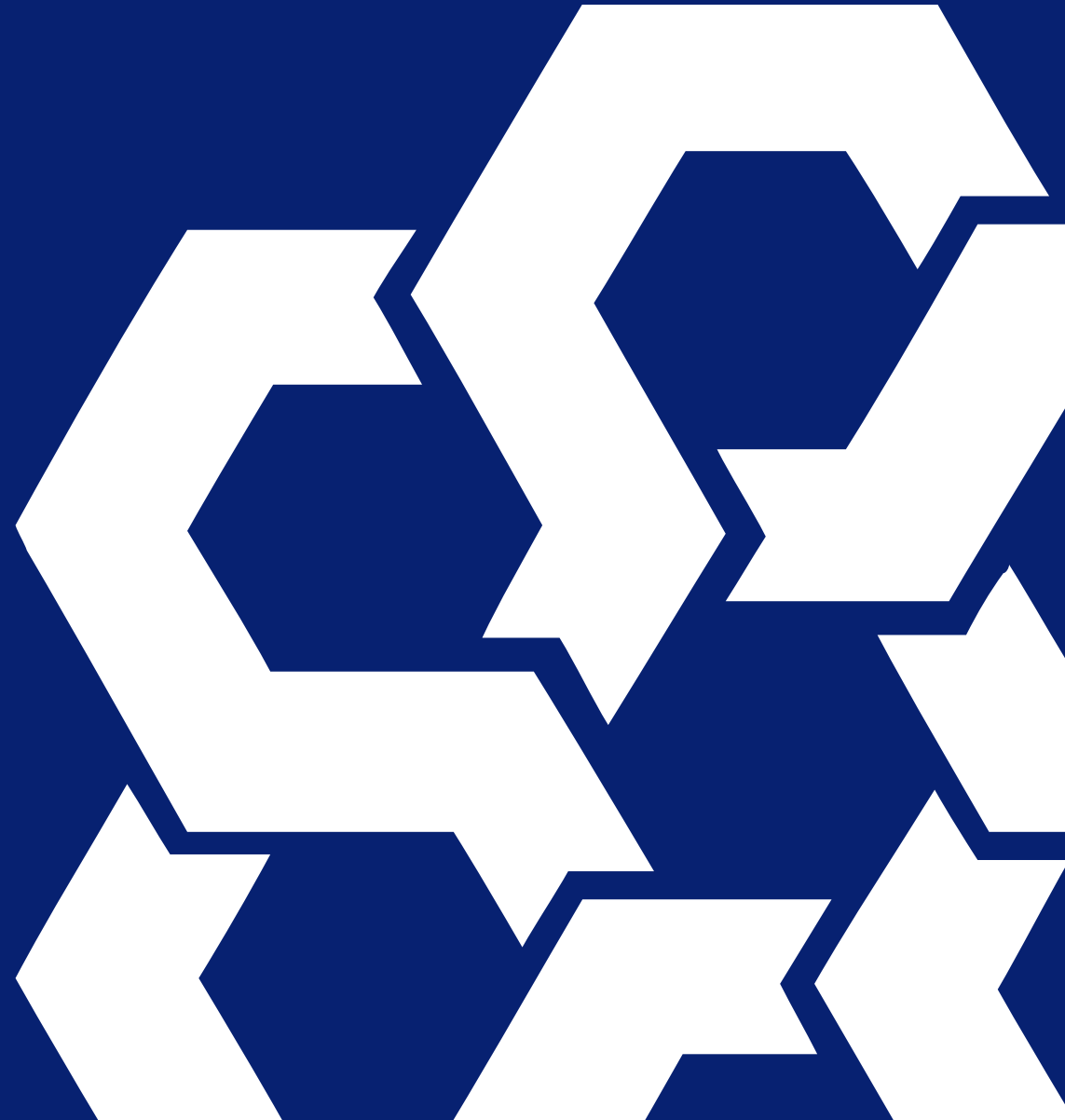
B. irrespective its ability to avoid exceeding the threshold—exceeding the threshold is not a separate action.

Expectations about the extent to which the entity will exceed the threshold could affect the measurement of the provision.\*

\* Circumstances are perhaps analogous to those in which different income tax rates apply to different levels of taxable income? IAS 12 *Income Taxes* requires deferred tax to be measured at average rate expected to apply.

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## Topic 3—Guidance on meaning of ‘no practical ability to avoid’



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## Guidance on meaning of ‘no practical ability to avoid’

### IAS 37

#### Existing requirements and guidance

- IAS 37 defines an obligating event as an event that creates an obligation an entity has ‘no realistic alternative to settling’.
- Paragraph 17(a) of IAS 37 states that an entity has no realistic alternative to settling a legal obligation only ‘where settlement of the obligation can be enforced by law’.

### Agenda Paper 6A

#### Possible new requirements

- Applying the *Conceptual Framework*, an obligation would be defined as ‘a responsibility that an entity has no practical ability to avoid’.
- ‘No practical ability to avoid’ is intended to have the same meaning as ‘no realistic alternative to settling’.



#### Questions for further analysis and discussion

- What, if any guidance, should IAS 37 provide on the meaning of ‘no practical ability to avoid’?
- Should that guidance retain the statement that it is necessary that a legal obligation ‘can be enforced by law’?

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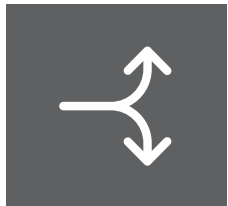
## Factors to consider in developing guidance

### Paragraph 4.34 of the *Conceptual Framework*



“The factors used to assess whether an entity has the practical ability to avoid transferring an economic resource may depend on the nature of the entity’s duty or responsibility. For example, in some cases, an entity may have no practical ability to avoid a transfer if any action that it could take to avoid the transfer would have economic consequences significantly more adverse than the transfer itself. However, neither an intention to make a transfer, nor a high likelihood of a transfer, is sufficient reason for concluding that the entity has no practical ability to avoid a transfer.”

### Difficulties in applying the requirement that a legal obligation can be enforced by law



- Some recent (often climate-related) laws are not enforceable in conventional ways, ie by through court action. Instead, the laws provide entities with economic incentives to comply or give governments the right to impose economic sanctions (eg, restrictions on future market access) on entities that fail to comply.
- As a result, some entities are economically compelled to comply with the laws. However, views differ on whether these entities have obligations that ‘can be enforced by law’ and hence on whether the criteria for recognising a provision are met.
- See paragraphs 19–21 and 41–44 of Agenda Paper 6A for further discussion.



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