IFRS® Accounting

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IFRS® Accounting Standard

Basis for Conclusions on Provisions—Targeted Improvements

Proposed amendments to IAS 37

Comments to be received by 12 March 2025

International Accounting Standards Board

IASB/ED/2024/8

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Basis for Conclusions on Exposure Draft *Provisions—Targeted Improvements*

This Basis for Conclusions accompanies, but is not part of, Exposure Draft Provisions—Targeted Improvements. *It summarises the considerations of the International Accounting Standards Board (IASB) when developing the Exposure Draft. Individual IASB members gave greater weight to some factors than to others.*

Background

BC1 In 2020 the IASB added a standard-setting project to its work plan, with the objective of making three targeted improvements to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*:

(a) aligning the definition of a liability and the recognition criterion that applies that definition with the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*) issued in 2018; and

(b) specifying two aspects of the requirements for measuring a provision:

(i) the costs an entity includes in its estimate of the future expenditure required to settle the present obligation; and

(ii) the rate an entity uses to discount that future expenditure to its present value.

BC2 For each topic, the IASB developed options for possible amendments and consulted stakeholders before making tentative decisions on the proposals included in the Exposure Draft. These stakeholders included:

(a) users of financial statements (investors), including the IASB's Capital Markets Advisory Committee and other groups of equity and debt analysts;

(b) preparers of financial statements, including the IASB's Global Preparers Forum and preparers of the financial statements of entities that could be most affected by the proposed amendments—entities operating in sectors that are subject to levies and entities reporting large long-term asset decommissioning or environmental rehabilitation obligations;

(c) national and regional standard-setting bodies, including the IASB's Accounting Standards Advisory Forum and Emerging Economies Group; and

(d) members of the IFRS Interpretations Committee.

Definitions and present obligation recognition criterion

BC3 The IASB proposes to amend:

(a) the definition of a liability in IAS 37;

(b) the recognition criterion in IAS 37 that uses that definition; and

(c) the supporting guidance in the *Guidance on implementing IAS 37* Provisions, Contingent Liabilities and Contingent Assets (*Guidance on implementing IAS 37*).

Reasons for proposing amendments

BC4 One of the criteria in IAS 37 for recognising a provision is that the entity has an obligation that meets the definition of a liability. Paragraph 14(a) of IAS 37 requires that the entity has a present obligation (legal or constructive) as a result of a past event (present obligation recognition criterion).

BC5 Paragraphs 17–22 of IAS 37 set out requirements for identifying when an entity has such an obligation, and examples in the *Guidance on implementing IAS 37* illustrate the application of those requirements.

BC6 The IASB is proposing to amend the requirements and examples supporting the present obligation recognition criterion because of:

(a) difficulties faced by preparers of financial statements in disentangling two distinct conditions within the criterion (paragraphs BC8–BC12);

(b) stakeholder dissatisfaction with IFRIC 21 *Levies*, which interprets the present obligation recognition criterion (paragraphs BC13–BC14); and

(c) difficulties in applying the requirements to laws and regulations with novel enforcement mechanisms or settlement options (paragraphs BC15–BC16).

BC7 The proposed amendments would affect only the present obligation recognition criterion. They would not affect the other two recognition criteria in IAS 37, which would continue to require an entity to recognise a provision only if:

(a) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation (paragraph 14(b) of IAS 37); and

(b) a reliable estimate can be made of the amount of the obligation (paragraph 14(c) of IAS 37).

Difficulties in disentangling two distinct conditions within the present obligation recognition criterion

BC8 Paragraphs 17–22 of IAS 37 identify two conditions within the present obligation recognition criterion:

(a) an obligation condition—there exists a mechanism, for example, a law or a policy the entity has published, that imposes responsibilities on the entity and leaves the entity with no realistic alternative to discharging those responsibilities if a specific event occurs; and

(b) a past-event condition—the specific event has occurred and consequently the obligation is a present obligation.

BC9 The obligation and past-event conditions are distinct—the obligation condition relates to the strength of the mechanism that requires the entity to settle a present obligation once it has arisen, whereas the past-event condition relates to the timing of the event that gives rise to the present obligation. However, although the obligation and past-event conditions are distinct, IAS 37 does not identify them separately. Instead, it combines them into a single requirement for an 'obligating event', which paragraph 10 in IAS 37 defines as 'an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation'. The supporting explanations in paragraphs 17–22 of IAS 37 also combine explanations of the obligation and past-event conditions.

BC10 Application problems arise because it can be unclear which condition an explanation refers to, so an explanation of one condition can appear to apply to the other condition. For example, paragraph 19 of IAS 37 refers to an entity having no present obligation if it can avoid future expenditure through its future actions. It is unclear whether this reference applies to actions the entity could take to avoid creating a present obligation (the past-event condition) or to actions it could take to avoid settling the obligation (the obligation condition).

BC11 In response to requests for more guidance for specific fact patterns, the IFRS Interpretations Committee has issued:

(a) two IFRIC® Interpretations: IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* and IFRIC 21; and

(b) Agenda Decision *Climate-related Commitments* (IAS 37).

BC12 In each case, the IFRS Interpretations Committee applied paragraph 19 of IAS 37 and concluded that an entity does not have a present obligation until it takes the action that triggers a requirement to discharge a responsibility (for example, to pay a levy or to offset greenhouse gas emissions), even if before then the entity would have had no realistic alternative other than to take that action. However, in each case, the conclusions and their rationale would have been easier to explain if IAS 37 more clearly distinguished the obligation condition from the past-event condition.

Stakeholder dissatisfaction with IFRIC 21

BC13 IFRIC 21 includes requirements for circumstances in which a levy is charged only if an entity takes two or more specific actions—for example, if an entity generates revenue in a market in one year and is still operating in that market on a specific date in the next year. IFRIC 21 concludes that a liability to pay the levy arises, and hence a provision is recognised, only when the entity takes the last of those actions, triggering the charge.

BC14 However, IFRIC 21 has been widely criticised by investors, preparers and auditors of financial statements, and national standard-setters. It results in entities recognising some recurring periodic levies as expenses at a single point in time late in the period for which they are charged, or even after the end of that period. Stakeholders have expressed concern about this outcome because, in their view, the substance of a recurring levy is that the entity is paying to operate over a period, and this substance would be more faithfully represented if entities recognised the expense systematically over that period. Stakeholders have also noted that the requirements in IFRIC 21 are inconsistent with requirements in IFRS Accounting Standards for other types of costs that are triggered only when an entity takes the last of two or more specific actions—for example, requirements in IFRS 2 *Share-based Payment* and IAS 19 *Employee Benefits.*

Difficulties in applying the requirements to laws and regulations with novel enforcement mechanisms or settlement options

BC15 Further questions have arisen recently because some new laws and regulations have features that differ from those of conventional laws. For example:

(a) the obligations arising under some climate-related regulations are not conventionally enforceable. An entity might not be required to comply with the regulations but might have a strong economic incentive to do so.

(b) an entity might be able to settle its obligations in a novel way—for example, by changing its future operations instead of by paying penalties.

BC16 The IFRS Interpretations Committee considered the implications of such features when asked to analyse government measures to encourage vehicle producers to produce low-emission vehicles. Although the Committee concluded in Agenda Decision *Negative Low Emission Vehicle Credits* (IAS 37) that IAS 37 provides an adequate basis to determine the required accounting, the conclusions and their rationale would have been easier to explain if IAS 37:

(a) more clearly distinguished and explained the obligation and past-event conditions within the present obligation recognition criterion.

(b) provided clearer application guidance on the factors to consider in assessing whether an entity has a realistic alternative to settling an obligation. Currently, paragraph 17 of IAS 37 states that it is necessary that a legal obligation 'can be enforced by law'. However, IAS 37 does not clarify how to interpret this statement if a counterparty cannot use the courts to enforce compliance but has a legal right to impose economic sanctions that might leave an entity with no realistic alternative other than to comply.

Revisions to the *Conceptual Framework*

BC17 The criticisms of IFRIC 21 described in paragraph BC14 highlight a question the IASB has considered in developing various IFRS Accounting Standards—whether and, if so, when a liability arises for an obligation that depends on an entity taking two or more separate actions. The IASB decided to answer this question as part of its project to revise the *Conceptual Framework* because the same question arises for various types of transactions—for example, share-based payments, variable lease payments and purchases subject to variable or contingent consideration. The IASB added concepts to address this question to the *Conceptual Framework* in 2018.

BC18 Although the IASB designed these concepts to have general applicability, it developed them with IAS 37 in mind. The IASB included concepts in the *Conceptual Framework* that it could apply in developing requirements for IAS 37 that would be clearer and result in more useful information for investors.

BC19 The *Conceptual Framework*:

(a) has an updated definition of a liability;

(b) distinguishes three conditions within the definition of a liability—obligation, transfer and past-event conditions—and explains each of these three conditions separately without referring to obligating events;

(c) identifies various circumstances in which an entity might have no realistic alternative to settling an obligation, considering the role of economic incentives; and

(d) provides new concepts for identifying the past event that gives rise to a present obligation.

BC20 The *Conceptual Framework* uses different terminology from that in IAS 37, referring to an entity's 'practical ability to avoid' an obligation rather than its 'realistic alternative to settling' the obligation. However, the Basis for Conclusions on the *Conceptual Framework* clarifies that the IASB viewed these two terms as having a similar meaning.[1]

Proposed amendments to IAS 37

BC21 The amendments proposed in the Exposure Draft use the concepts added to the *Conceptual Framework* to address the problems described in paragraphs BC8–BC16. The proposed amendments consist of:

(a) updating the definition of a liability to align it with the definition in the *Conceptual Framework* (paragraphs BC22–BC24);

(b) aligning the wording of the present obligation recognition criterion with the updated definition of a liability (paragraph BC25);

(c) removing the term 'obligating event' and instead identifying and explaining three conditions (obligation, transfer and past-event conditions) within the present obligation recognition criterion (paragraphs BC26–BC33);

(d) redefining a past event (paragraphs BC34–BC36);

(e) adding requirements for threshold-triggered costs (paragraphs BC37–BC47); and

1 See paragraph BC4.57 of the Basis for Conclusions on the *Conceptual Framework for Financial Reporting*.

(f) improving the wording of the requirements for restructuring costs without changing the substance of those requirements (paragraphs BC48–BC52).

Updating the definition of a liability

BC22 The IASB proposes to update the definition of a liability in paragraph 10 of IAS 37 to align it with the definition in paragraph 4.2 of the *Conceptual Framework*.

BC23 IAS 37 is the only IFRS Accounting Standard that uses a definition of a liability that predates the *Conceptual Framework* definition. Updating the definition in IAS 37 would result in IFRS Accounting Standards using a single definition of a liability, which could reduce complexity for preparers of financial statements. For example, in developing an accounting policy for a transaction not specifically addressed by any IFRS Accounting Standard, preparers would no longer be required to decide whether to apply the IAS 37 definition or the *Conceptual Framework* definition.

BC24 Updating the definition of a liability in paragraph 10 of IAS 37 would require minor consequential amendments to various other paragraphs in IAS 37 that include words or phrases from the definition. These consequential amendments are set out in Appendix A to the Exposure Draft.

Aligning the wording of the present obligation recognition criterion with the updated definition of a liability

BC25 The present obligation recognition criterion in paragraph 14(a) of IAS 37 is a requirement for an entity to have an obligation that meets the definition of a liability. The IASB proposes to align the wording of this criterion with the updated definition of a liability to make that relationship clearer.

Identifying three conditions within the present obligation recognition criterion

BC26 To clarify the present obligation recognition criterion, the IASB proposes to remove the requirement for an obligating event (paragraph 17 of IAS 37) and replace it with a requirement to meet the three distinct conditions—obligation, transfer and past-event conditions—identified in paragraph 4.27 of the *Conceptual Framework* (paragraph 14A of the Exposure Draft).

BC27 The IASB proposes separate sections of requirements to support each of the conditions. In developing these requirements, the IASB has applied concepts set out in the corresponding sections of the *Conceptual Framework*.

Clarifying the requirements supporting the obligation condition

BC28 Paragraph 4.29 of the *Conceptual Framework* defines an obligation as ‘a responsibility that an entity has no practical ability to avoid’. In paragraph 14B of the Exposure Draft, the IASB proposes to use that definition as the basis for the definition in IAS 37. The IASB has previously concluded that the meaning of ‘no practical ability to avoid’ is similar to that of ‘no realistic alternative to settling’ (see paragraph BC20). Therefore, it does not expect the change in terminology to change the outcomes of applying IAS 37.

BC29 The paragraphs explaining the obligation condition (paragraphs 14B–14H of the Exposure Draft) have two main aims. The first aim is to clarify that the 'no practical ability to avoid' requirement in the obligation condition refers to an entity's ability to avoid discharging a responsibility *if* it obtains specific benefits or takes a specific action, not its ability to avoid obtaining those benefits or taking that action. In other words, the obligation condition requires an assessment of the entity's practical ability to avoid settling an obligation once that obligation has been created, not the entity's practical ability to avoid obtaining the benefits or taking the action that creates the obligation. The entity's ability to avoid obtaining the benefits or taking the action is considered separately, in applying the past-event condition.

BC30 A second aim of the paragraphs supporting the obligation condition is to clarify the circumstances in which an entity has no practical ability to avoid discharging a legal responsibility. The IASB proposes to remove the statement specifying that it is necessary that settlement of a legal obligation 'can be enforced by law' (paragraph 17 of IAS 37) because the phrase 'enforced by law' has proved difficult to apply to some types of obligations within the scope of IAS 37. The phrase can be interpreted narrowly, to mean that the counterparty can use the courts to enforce compliance (see paragraph BC16(b)). For some types of obligations within the scope of IAS 37, this narrow interpretation might be inconsistent with the broader notion of 'no practical ability to avoid'—an entity might have no practical ability to avoid discharging a legal obligation for reasons other than the counterparty's ability to use the courts to enforce compliance.

BC31 In paragraph 14F(a) of the Exposure Draft, the IASB proposes to replace the requirement that a legal obligation can be 'enforced by law' with a more detailed description of circumstances in which an entity would have no practical ability to avoid discharging a legal obligation. The proposed description is based on concepts in paragraph 4.34 of the *Conceptual Framework*. These concepts focus on the effects of the counterparty's rights on the entity's ability to avoid discharging a legal responsibility, not on the form of the rights.

Adding requirements to support the transfer condition

BC32 The proposed new explanation of the transfer condition (paragraphs 14I–14L of the Exposure Draft) reflects concepts from the *Conceptual Framework*. The IASB proposes to add these concepts to explain:

(a) the need for the obligation to have only the potential to require a transfer of an economic resource—a transfer need not be certain or even likely;

(b) the consequences of uncertainty about whether the obligation will require a transfer of an economic resource; and

(c) the reason that a provision is recognised for an obligation to exchange resources only if the exchange is unfavourable to the entity—for example, if an executory contract is onerous. No provision is recognised in other circumstances because the obligation does not meet the transfer condition.

BC33 In paragraph 3 of the Exposure Draft, the IASB proposes to amend the description of an executory contract to align it with the definition in paragraph 4.56 of the *Conceptual Framework*. This amendment is intended only to eliminate an unnecessary wording difference within IFRS Accounting Standards. It is not intended to change the meaning of the term executory contract as it is applied in IAS 37.

Redefining a past event

BC34 In paragraphs 14M–14R of the Exposure Draft, the IASB proposes new requirements for identifying the past event that gives rise to a present obligation. The IASB developed those requirements by applying concepts in paragraphs 4.43–4.44 and 4.32–4.33 of the *Conceptual Framework*. The proposed requirements aim to address the criticisms of IFRIC 21 discussed in paragraphs BC13–BC14—in particular, the criticisms relating to the outcomes of applying IFRIC 21 to levies charged only if an entity takes two or more specific actions. The proposed requirements would replace the current requirements in paragraph 19 of IAS 37, and IFRIC 21 would be withdrawn.

BC35 The proposed requirements would change the timing of recognition of some provisions. The timing would change for a transfer of economic resources that is required only if an entity takes two or more separate actions. Currently, an entity applying paragraph 19 of IAS 37, as interpreted by IFRIC 21, is regarded as having met the past-event condition only when it has taken the *last* of the required actions, thus triggering the transfer. In contrast, an entity applying the proposed requirements would be regarded as having met the past-event condition as soon as it had taken *any* of the actions and if it had no practical ability to avoid the remaining actions. Assuming the other recognition criteria are met, the latter entity might recognise a provision earlier and might accrue that provision progressively instead of recognising it at a point in time. The aim of the proposed requirements is to provide more useful information to investors, as explained in paragraphs BC4.51–BC4.52 of the Basis for Conclusions on the *Conceptual Framework*.

BC36 The IASB noted that whether an entity's obligation to transfer an economic resource requires only one action of the entity (perhaps taken over time), or a combination of two or more separate actions, will depend on the precise facts of the mechanism that has created the obligation—for example, the precise terms of a contract or requirements of legislation. Management would reach a conclusion by assessing all the relevant facts of the mechanism, including, for example, facts about the effects on the obligation of variations in an entity's circumstances.

Adding requirements for threshold-triggered costs

BC37 In paragraph 14P of the Exposure Draft, the IASB proposes to add to IAS 37 requirements for costs payable if a measure of an entity's activity in a specific period exceeds a specific threshold (threshold-triggered costs). The proposed requirements aim to clarify when the past-event condition is met for such costs.

BC38 Examples of such costs are:

(a) levies payable by larger entities operating within a market—for example, levies payable by entities whose annual revenue exceeds a specific amount; and

(b) some costs imposed by pollutant pricing mechanisms and other climate-related regulations—for example, penalties imposed on an entity whose greenhouse gas emissions in a specific assessment period exceed a quota allocated to that entity.

BC39 Stakeholders have told the IASB that specific requirements are necessary for threshold-triggered costs because:

(a) such costs are common in some sectors—for example, pharmaceutical or oil and gas—and are becoming more common because they are a feature of some climate-related regulations;

(b) questions arise in practice about whether the past-event condition for a threshold-triggered cost is met:

  (i) when an entity starts to carry out the activity that contributes to the total activity on which the cost is assessed (if the entity expects that activity to exceed the threshold in the assessment period); or

  (ii) only when the entity's activity exceeds the threshold;

(c) without specific requirements, there is a risk of inconsistent application of the more general requirements in IAS 37; and

(d) specific requirements would be especially useful for interim financial statements.

BC40 The requirements proposed in paragraph 14P of the Exposure Draft are an interpretation of the more general requirements proposed in paragraph 14N, which state that an entity has a present obligation as a result of a past event when it:

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

(b) as a consequence, will or may have to transfer an economic resource it would not otherwise have had to transfer.

BC41 The requirements proposed in paragraph 14P of the Exposure Draft are based on the IASB's conclusion that the action that satisfies the past-event condition is all activity that contributes to the total activity on which the cost is assessed, both activity below the threshold and activity above the threshold.

The consequence of this conclusion is that the past-event condition starts to be met as soon as an entity starts carrying out the activity that contributes to the total being assessed. The present obligation accumulates as that activity progresses.

BC42 The IASB is proposing these requirements having concluded that, regardless of whether an entity's activity at a date within the assessment period is below or above the threshold, the fact that the entity has carried out activity that takes it towards or further above the threshold affects the costs it might incur. An entity whose activity is closer to the threshold might incur a cost that it would not have incurred without that activity.

BC43 Some stakeholders the IASB consulted expressed a view that an entity should recognise a provision for a threshold-triggered cost only when the entity's activity exceeds the threshold. These stakeholders said that:

(a) estimating the amount of the obligation before the activity exceeds the threshold could be difficult and costly for preparers of financial statements, especially in borderline cases—for example, if the threshold is unlikely to be exceeded until near the end of the assessment period.

(b) the resulting estimates could be highly subjective, especially if there is a lack of historical information on which to base estimates or a history of poor judgement by management. In some cases, an entity might recognise a provision in one period and reverse it in a later period if expectations change.

(c) a requirement to recognise a provision only after an entity's activity exceeds the threshold would be clearer and easier to apply.

BC44 However, the IASB concluded that:

(a) a present obligation for a threshold-triggered cost starts to arise when an entity starts to carry out the activity on which the cost is assessed.

(b) accruing a provision based on the expected cost attributable to each unit of activity would provide useful information to investors. In contrast, recognising a provision only after the threshold has been met could provide misleading information to investors. Recognition at this stage might not faithfully represent the entity's financial performance and financial position in its (interim) financial statements for periods before and after the threshold is met.

BC45 The IASB further noted that an entity applying the proposed amendments would not necessarily recognise a provision before its activity exceeded the threshold. The entity would recognise a provision only if the other recognition criteria in IAS 37 were also met, that is, if:

(a) it were probable that a transfer of economic resources would be required to settle the obligation (paragraph 14(b) of IAS 37); and

(b) a reliable estimate could be made of the amount of the obligation (paragraph 14(c) of IAS 37).

BC46 The IASB concluded that, as a consequence, an entity would recognise a provision for a threshold-triggered cost only if:

(a) the entity's activity for the assessment period were expected to exceed the threshold; and

(b) the entity could make a forecast of the total activity for the assessment period that was sufficiently reliable to use in recognising the provision (as required by paragraph 25 of IAS 37).

BC47 The requirements proposed in paragraph 14P of the Exposure Draft are consistent with:

(a) requirements in IAS 12 *Income Taxes* for measuring tax liabilities when different tax rates apply to different levels of taxable income; and

(b) requirements in IAS 19 for employee profit-sharing and bonus payments payable only if specific conditions are met.

IAS 12 and IAS 19 treat the liability as arising in the period in which the entity generates taxable income or receives employee services, and they require liabilities to be recognised by estimating and apportioning the total amounts expected to be payable for that period.

Improving the wording of the requirements for restructuring costs

BC48 Paragraphs 70–83 of IAS 37 set out recognition requirements for restructuring provisions. They:

(a) require an entity to recognise a restructuring provision when it has a 'constructive obligation to restructure'; and

(b) state 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 its main features to those affected by it.

BC49 The IASB has become aware that inappropriate analogies are being drawn from these requirements because the wording implies that the public announcement of a restructuring plan is enough to meet the past-event condition and thus create a present obligation for restructuring costs. By analogising to the requirements for restructuring provisions, stakeholders have sometimes concluded that an entity that has publicly announced a plan to change its operations in the future—for example, to reduce its annual greenhouse gas emissions in future years—has a present obligation for the future costs of changing its operations.

BC50 The IASB has concluded that some of the wording of the requirements in IAS 37 for restructuring provisions contributes to the misunderstanding. IAS 37 should not refer to a 'constructive obligation to restructure' because:

(a) restructuring is an activity implemented for the benefit of the entity, not an obligation owed to another party. An entity does not have an obligation to restructure but rather might have obligations to discharge specific responsibilities *if* it restructures—for example, to pay redundancy costs to employees whose employment is terminated as part of the restructuring.

(b) the obligations arising from a restructuring are not necessarily constructive. They are created by mechanisms other than the implementation or announcement of a restructuring plan. The mechanism creating an obligation could be:

  (i) legal—for example, a statutory or contractual requirement to pay termination benefits to employees; or

  (ii) constructive—for example, an entity's statement that it will provide employees with termination benefits beyond those to which the employees are legally entitled.

(c) the obligations are present obligations (meaning the past-event condition is met) only if the requirement to pay the restructuring costs is a consequence of the entity:

  (i) having obtained specific economic benefits or taken a specific action in the past—for example, having employed and obtained services from employees in the past; and

  (ii) having no practical ability to avoid a second specific action required to trigger the payments—for example, making these employees redundant—because it has no practical ability to avoid the restructuring.

BC51 The IASB has concluded that although some of the wording of the restructuring requirements in IAS 37 appears inconsistent with the analysis in paragraph BC50, the requirements themselves are consistent with that analysis. The requirements in IAS 37 are such that for a provision to be recognised, it is necessary that the entity has announced or started to implement a restructuring plan, and thus has no practical ability to avoid the restructuring. It is also necessary that the costs included in the provision arise from the entity having taken a specific action or obtained specific benefits in the past—for example, having employed and obtained services from employees in the past. This requirement is reflected in paragraph 80 of IAS 37, which requires entities to exclude from a restructuring provision costs associated with the ongoing activities of the entity.

BC52 The proposed amendments to paragraphs 72–83 of IAS 37 aim to eliminate potentially misleading terminology and explain the requirements for restructuring provisions more clearly, to reduce the risk of inappropriate analogies being drawn from the requirements. The amendments are not intended to change the outcomes of applying the requirements for restructuring provisions.

Paragraph-by-paragraph explanation of proposed amendments

BC53 The amendments necessary to achieve the aims described in paragraphs BC26–BC47 are interrelated. The IASB proposes to achieve these aims by replacing paragraphs 17–22 of IAS 37 with new paragraphs numbered 14A–14U and by amending paragraphs 15–16 of IAS 37.

BC54 Appendix A to this basis for conclusions provides a paragraph-by-paragraph explanation of these proposed amendments. For each new or amended paragraph, it:

(a) identifies the function of the proposed requirement and its source—typically an existing paragraph in IAS 37 or a paragraph in the *Conceptual Framework*; and

(b) explains the contribution the paragraph makes to achieving the overall aims of the amendments.

Proposed amendments to the *Guidance on implementing IAS 37*

BC55 The *Guidance on implementing IAS 37* published with IAS 37 includes:

(a) a decision tree illustrating the process an entity follows in applying the three recognition criteria in paragraph 14 of IAS 37, and the consequences of meeting or failing to meet each criterion; and

(b) examples showing how to apply the present obligation recognition criterion to various fact patterns.

Expanding the decision tree

BC56 The proposed amendments to the present obligation recognition criterion would split the criterion into three separate conditions: obligation, transfer and past-event conditions. The IASB proposes to expand the decision tree in the *Guidance on implementing IAS 37* to show how a step-by-step assessment of these three conditions would fit into the wider process followed by an entity in applying the recognition criteria.

BC57 The proposed new decision tree also shows more prominently the consequence of an obligation failing to meet the present obligation recognition criterion; namely that the entity has neither a provision nor a contingent liability. Giving more prominence to this consequence could help overcome a common misunderstanding, which is that an obligation that fails any of the criteria for recognising a provision is a contingent liability.

Adding illustrative examples

BC58 The IASB proposes to add further examples to the *Guidance on implementing IAS 37*. These proposed examples illustrate the application of the recognition criteria to fact patterns similar to those in:

(a) IFRIC 6 (proposed Example 12);

(b) Illustrative Examples accompanying IFRIC 21 (proposed Example 13A and Example 13B);

(c) Agenda Decision *Negative Low Emission Vehicle Credits* discussed in paragraph BC16 (proposed Example 14); and

(d) Agenda Decision *Climate-related Commitments* discussed in paragraph BC11 (proposed Example 15).

BC59 Adding these examples to the *Guidance on implementing IAS 37* would allow the IASB to withdraw the interpretations and agenda decisions without losing an analysis of the fact patterns they discuss. Moving that analysis to the *Guidance on implementing IAS 37* would also help consolidate the guidance in one place, making it more accessible. Including examples illustrating the application of the proposed new requirements to levies with fact patterns like those accompanying IFRIC 21 would help illustrate how the outcomes of applying the proposed requirements differ from the outcomes of applying IFRIC 21.

Amending existing examples

BC60 The IASB proposes to amend the analysis in the existing examples in the *Guidance on implementing IAS 37* to reflect the proposed new requirements supporting the present obligation recognition criterion. In the IASB's view, none of the conclusions on whether a provision is recognised would change, but some would be explained in another way.

BC61 The IASB proposes to expand the analysis of each example to include a conclusion on whether each of the three conditions within the present obligation recognition criterion is met. The aim of expanding the analysis in this way is to further clarify the three conditions to help preparers of financial statements apply them to other fact patterns, including new fact patterns that might emerge in the future. In practice, it might be unnecessary to assess all three conditions, because failing to meet any one condition is sufficient to conclude that the present obligation recognition criterion is not met.

BC62 The IASB proposes to delete Example 4 (Refunds policy) because, following the issue of IFRS 15 *Revenue from Contracts with Customers*, this example is no longer applicable.

Measurement—Expenditure required to settle an obligation

BC63 In May 2020 the IASB issued a narrow-scope amendment to IAS 37, adding paragraph 68A. Paragraph 68A specifies the costs an entity includes in assessing whether a contract is onerous, and hence in determining whether the entity recognises an onerous contract provision. It requires an entity to include the incremental costs of fulfilling that contract and an allocation of other costs that relate directly to fulfilling contracts—for example, an allocation of the depreciation charge for an item of plant or equipment.

BC64 While the IASB was developing that narrow-scope amendment, some stakeholders asked it to clarify:

(a) whether an entity that has used the costs set out in paragraph 68A of IAS 37 to determine whether a contract is onerous is required to include the same costs in measuring the resulting onerous contract provision; and

(b) whether an entity is also required to include the same types of costs in measuring other types of provisions within the scope of IAS 37.

BC65 The IASB decided not to respond to these questions at the time because doing so would have delayed an urgent amendment. Paragraph BC19 of the Basis for Conclusions on IAS 37 includes a statement that adding paragraph 68A to IAS 37 does not change the requirements in the Standard beyond clarifying the costs an entity is required to consider in determining whether a contract is onerous.

BC66 This statement leaves open the question of which costs an entity includes in measuring an onerous contract provision and, more broadly, in measuring any type of provision within the scope of IAS 37. To answer this question, the IASB proposes to specify that, in measuring a provision, an entity includes the types of costs it would include in assessing whether a contract is onerous. This proposal reflects the IASB's view that:

(a) the basis for measuring an onerous contract provision should be consistent with the basis on which the contract has been assessed to be onerous; and

(b) the arguments on which the IASB based its conclusions about the costs of fulfilling an onerous contract obligation (see paragraphs BC4–BC13 of the Basis for Conclusions on IAS 37) apply equally to the expenditure required to settle other types of provisions within the scope of IAS 37.

Measurement—Discount rates

Determining the discount rate

Current requirements

BC67 Paragraph 36 of IAS 37 requires an entity to measure a provision by estimating the expenditure required to settle the present obligation. Paragraph 45 of IAS 37 requires the entity to discount this expenditure to its present value if the effect of the time value of money is material. Paragraph 47 of IAS 37 requires an entity to discount the expenditure at a rate that reflects:

(a) current market assessments of the time value of money; and

(b) the risks specific to the liability, to the extent that these risks are not reflected in the cash flows.

BC68 The risks specific to the liability include the uncertainty in the amount or timing of the expenditure required to settle the liability. This type of risk typically increases the measure of the liability, and it can be reflected by:

(a) increasing the estimate of the expenditure required to settle the liability (increasing the estimated expenditure to its certainty equivalent amount[2]); or

(b) decreasing the rate used to discount the estimated expenditure to its present value.

BC69 IAS 37 does not specify whether the risks specific to the liability also include non-performance risk—the risk that the entity will not settle the liability. If non-performance risk is reflected, the amount at which a liability is measured decreases. Non-performance risk is reflected by increasing the discount rate.

BC70 The non-performance risk associated with a provision might differ from the non-performance risk associated with an entity's other liabilities. For example, regulations governing asset decommissioning and environmental rehabilitation obligations sometimes reduce the non-performance risk associated with these obligations by requiring entities to fund the obligations, or by ranking the obligations higher than other liabilities in a liquidation.

Reasons for specifying whether to include or exclude non-performance risk

BC71 In the absence of specific requirements in IAS 37 on whether and how to include non-performance risk, practice varies:

(a) some entities exclude non-performance risk. Their accounting policy is to apply a risk-free rate, which they typically determine by reference to an observable market proxy for a risk-free rate—for example, the current yield on a low-risk government bond in a currency consistent with that of the provision.

(b) some entities include an entity-specific measure of non-performance risk. Their accounting policy is to apply a 'credit-adjusted' rate, which they might determine by reference to:

  (i) the entity's incremental or average borrowing rate; or

  (ii) an observable market proxy for a risk-free rate adjusted for the entity's credit spread.

(c) some entities include a market measure of non-performance risk—the non-performance risk in a particular class (or classes) of investment—for example, AA-rated corporate bonds. Such entities determine the discount rate by reference to the current market yield on that type of investment.

BC72 An entity that includes non-performance risk in the discount rate recognises smaller provisions than an entity that excludes that risk. The differences can be significant for large long-term provisions, such as the asset decommissioning and environmental rehabilitation provisions recognised by entities operating in the power generation, oil and gas, mining, and telecommunications sectors.

2 The maximum amount at which the entity would be willing to exchange its liability for one with certain cash outflows of the same amount.

BC73 If two entities use discount rates calculated on different bases for similar provisions, investors might have difficulty comparing the effect of those provisions on the entities' financial performance and financial position. To make comparisons, investors would need to adjust the amounts one entity reports so they are calculated on the same basis as the amounts the other entity reports. The calculations required are sometimes complex, and not all entities disclose the information necessary to make the appropriate adjustments.

BC74 Almost all stakeholders the IASB consulted said they would be in favour of amendments to IAS 37 to improve comparability. A few of those stakeholders said they thought it might be enough to enhance the disclosure requirements, but most said the IASB should standardise the rates entities use, by specifying in IAS 37 whether and how the rate includes non-performance risk.

Reasons for requiring entities to exclude non-performance risk

BC75 In paragraph 47 of the Exposure Draft, the IASB proposes to specify that an entity discounts a provision at a rate that reflects current market assessments of the time value of money, represented by a risk-free rate, with no adjustment for non-performance risk. An entity could estimate an appropriate rate by reference to an observable market proxy for a risk-free rate.

BC76 In reaching its conclusion that the rate should exclude non-performance risk, the IASB considered the alternative views of some stakeholders. As explained further in Appendix B, these stakeholders argued that a rate that *includes* non-performance risk:

(a) can be justified conceptually and results in information that could be useful to investors; and

(b) can be viewed as consistent with both:

  (i) the measurement objective of IAS 37; and

  (ii) the requirement in paragraph 47 of IAS 37 to reflect risks 'specific to the liability'.

BC77 However, as also explained further in Appendix B, the IASB noted it can be argued that a rate that excludes non-performance risk also fulfils these criteria. One conceptual justification for excluding non-performance risk reflects a difference between provisions within the scope of IAS 37 and liabilities that arise from exchange transactions. Provisions within the scope of IAS 37 (for example, asset decommissioning obligations) typically do not include an obligation for an entity to pay the counterparty compensation for accepting non-performance risk. By discounting a provision (and hence unwinding the discount) at a rate that excludes non-performance risk, an entity faithfully represents the fact that it does not incur an expense for transferring that risk.

BC78 In reaching its conclusion that the rate should exclude non-performance risk, the IASB considered two other factors:

(a) first, the IASB noted a preference among many stakeholders, including users and preparers of financial statements, for a rate that can be determined objectively by reference to an observable market rate. The non-performance risk associated with a provision is not observable and, as explained in paragraph BC70, can differ from the non-performance risk associated with an entity's other liabilities. Therefore, any estimate of the adjustment required to reflect non-performance risk could be highly subjective. Investors have said this subjectivity would reduce comparability. Preparers of financial statements have said the adjustment could be difficult and costly to estimate and audit.

(b) second, the IASB noted that the outcomes of measuring a provision at an amount that reflects the entity's own credit standing can be counter-intuitive. An entity with a weak credit standing reports a smaller liability than an entity with a stronger credit standing, and an entity with a deteriorating credit standing reports a reduction in its liabilities.

BC79 A few stakeholders said they would favour including non-performance risk in the discount rate because doing so would make the requirements in IAS 37 for asset decommissioning and associated environmental rehabilitation obligations more consistent with those in US generally accepted accounting principles (US GAAP). Under US GAAP, an entity measures these obligations using a credit-adjusted discount rate.[3]

BC80 However, the IASB concluded that a requirement to include non-performance risk in the measure of a provision would only marginally improve consistency between IAS 37 and US GAAP requirements because:

(a) the credit-adjusted rate entities use in applying US GAAP differs from the rate IAS 37 would require if it were to mandate inclusion of non-performance risk. The credit-adjusted rate entities use in applying US GAAP reflects those entities' credit standing at the date of initial recognition, but does not reflect:

  (i) changes in their credit standing after initial recognition; or

  (ii) the non-performance risk specifically associated with the liability being measured.

(b) there are several other differences between IAS 37 and US GAAP requirements for recognising and measuring asset retirement and associated environmental rehabilitation obligations.

Application guidance

BC81 The IASB proposes to add no application guidance to IAS 37 on how an entity determines an appropriate risk-free discount rate. In reaching this decision, the IASB noted that:

3 US GAAP requirements are set out in FASB ASC Subtopic 410–20 *Asset Retirement and Environmental Obligations*.

(a) practice is already well-established without guidance in IAS 37. Many preparers of financial statements already estimate a risk-free rate for measuring provisions, either to implement a policy of discounting at a risk-free rate or as the starting point for estimating a credit-adjusted rate.

(b) provisions within the scope of IAS 37 vary widely in their terms and the circumstances of their settlement. The IASB cannot develop guidance to cover all possible terms and circumstances and so might be unable to develop any guidance beyond basic principles that are already widely understood.

(c) several other IFRS Accounting Standards require assets or liabilities to be measured by reference to risk-free interest rates. Any guidance added to IAS 37 could have unintended consequences for those other Standards.

BC82 Typically, entities determine an appropriate risk-free rate by reference to an observable market proxy for a risk-free rate, such as the current yield on a low-risk government bond in a currency consistent with that of the provision. In some cases, an entity might adjust that yield—for example, to compensate for differences between the duration and liquidity of the investment and those of the provision. However, the IASB does not expect all entities to make such adjustments.

Disclosure—Discount rates

BC83 In response to requests from investors, the IASB proposes to add to IAS 37 requirements for an entity to disclose for each class of provision:

(a) the discount rate (or rates) used in measuring the provision; and

(b) the approach used to determine that rate (or those rates).

BC84 Investors giving feedback on the discount rate requirements in IAS 37 said comparability is impaired not only by diversity in the rates used, but also by a lack of information about those rates. Investors noted that other IFRS Accounting Standards that require entities to measure an asset or a liability using present value cash flow techniques—for example, IAS 19 and IAS 36 *Impairment of Assets*—also require entities to disclose the discount rates they have used. IAS 37 is, therefore, unusual in not requiring entities to disclose discount rates used.

BC85 The proposal to require an entity to disclose the approach it used to determine its discount rates follows from the proposal not to add application guidance to IAS 37 on how to determine an appropriate risk-free rate. The proposal acknowledges that entities could use various approaches and that information about the approach used would enhance comparability. The proposed requirement is consistent with a requirement in IFRS 17 *Insurance Contracts* to disclose the approach used to determine the discount rates used in measuring insurance contract liabilities.[4]

4 See paragraph 117(c)(iii) of IFRS 17 *Insurance Contracts*.

Withdrawal of IFRIC 6 and IFRIC 21

BC86 The IASB proposes to withdraw both IFRIC 6 and IFRIC 21 because the proposed requirements supporting the present obligation recognition criterion would supersede the requirements in those Interpretations. As discussed in paragraphs BC58–BC59, the IASB proposes to add to the *Guidance on implementing IAS 37* examples illustrating fact patterns like those described in IFRIC 6 and IFRIC 21, so the analysis in these Interpretations would not be lost.

Transition requirements

Entities applying IFRS Accounting Standards

BC87 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires an entity to account for a change in an accounting policy resulting from the initial application of an IFRS Accounting Standard:

(a) in accordance with the transition requirements set out in that Standard if it includes such requirements; or

(b) retrospectively if the Standard has no transition requirements.

BC88 The IASB concluded that the costs of retrospective application of some of the amendments proposed in the Exposure Draft could exceed the benefits. Therefore, it is proposing a general requirement for retrospective application with two simplifying exceptions. These exceptions are explained in paragraphs BC90–BC98.

BC89 Some provisions, for example, provisions for asset decommissioning obligations, are added to the cost of the asset to which they relate. Paragraph 94C of the Exposure Draft clarifies that if an entity adjusts a provision for such an obligation, the entity might also need to adjust the carrying amount of the related asset. The requirement for an entity to recognise the net difference as at the transition date in equity clarifies that the entity does not adjust the carrying amount of goodwill acquired in business combinations occurring before that date (subject to the requirements in paragraph 45 of IFRS 3 *Business Combinations*).

Modified retrospective approach for changes in costs included in the measure of a provision

BC90 The first exception to retrospective application is set out in paragraph 94D of the Exposure Draft. This exception specifies a modified retrospective approach for changes in the costs included in the measure of a provision resulting from the amendment proposed in paragraph 40A of the Exposure Draft.

BC91 The IASB is proposing this modified retrospective approach because:

(a) the IASB required this approach when it amended IAS 37 in 2020 to specify the costs an entity includes in assessing whether a contract is onerous; and

(b) the amendments proposed in paragraph 40A follow from the 2020 amendment described in (a). The arguments made in support of the modified retrospective approach specified in the 2020 amendment (see paragraphs BC20–BC21 of the Basis for Conclusions on IAS 37) also apply to the amendment proposed in paragraph 40A.

Simplified approach for changes in discount rates

BC92 The second exception to retrospective application is set out in paragraph 94E of the Exposure Draft. This exception would permit a simplified retrospective approach for changes in discount rates resulting from the amendments proposed in paragraph 47A of the Exposure Draft. The simplification would apply to changes affecting the measure of a provision for asset decommissioning or restoration costs, if those costs are added to the cost of a related asset—for example, related property, plant and equipment or a related lease right-of-use asset. The proposed exception is similar to the exception set out in paragraph D21 of IFRS 1 *First-time Adoption of International Financial Reporting Standards*. The reason for proposing the exception is explained in paragraphs BC93–BC98 below.

BC93 In paragraph 47A of the Exposure Draft, the IASB proposes to specify that the rate an entity uses to discount a provision reflects current market assessments of the time value of money, represented by a risk-free rate, without adjustment for non-performance risk.

BC94 An entity that currently discounts an asset decommissioning or restoration provision at a rate that includes non-performance risk would need to change its accounting policy to use a lower rate, with a resulting increase in the measure of the provision.

BC95 The IASB concluded that applying the change in accounting policy retrospectively could be difficult if the corresponding debit is added to the cost of the related asset.

BC96 The difficulty would arise because:

(a) IAS 37 requires an entity to measure a provision using current estimates of the expenditure required to settle the present obligation and a current market assessment of the time value of money. Consequently, the measure of an asset decommissioning or environmental rehabilitation provision can fluctuate between reporting dates due to changes in estimates of the required expenditure or changes in current market interest rates.

(b) IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* requires the fluctuations described in (a) to be added to, or deducted from, the cost of the related asset. Consequently, the fluctuations are generally recognised in the statement of profit or loss prospectively as the related asset is depreciated over its useful life or becomes impaired. Accordingly, the carrying amount of the asset at the date of transition could depend on when and how estimates of required expenditure and market interest rates fluctuated from the date the decommissioning obligation arose.

(c) therefore, retrospective application of the change in accounting policy would necessitate an entity constructing a historical record of every adjustment that would have been made to the asset's cost and accumulated depreciation at each reporting date between initial recognition of the provision and the date of transition.

BC97 The IASB previously concluded that constructing such a historical record would be impracticable for first-time adopters of IFRS Accounting Standards.[5] For this reason, IFRS 1 exempts first-time adopters from applying IFRIC 1 for fluctuations in estimates of the cash outflows and market interest rates that occurred before the date of transition to IFRS Accounting Standards. Paragraph D21 of IFRS 1 sets out a simplified retrospective approach for an entity that chooses to use this exemption. Applying that simplified approach, an entity measures the provision at the date of transition in accordance with the requirements in IAS 37 and estimates the amount that would have been included in the cost and accumulated depreciation of the related asset using simplifying assumptions.

BC98 The IASB has concluded that a similar exemption would be justified for an entity that changes its accounting policy as a result of the amendments proposed in the Exposure Draft.

First-time adopters of IFRS Accounting Standards

BC99 IFRS 1 requires first-time adopters of IFRS Accounting Standards to apply the requirements retrospectively, with some exceptions. When the IASB issues a new Standard or makes significant changes to a Standard, it considers whether to remove any of those exceptions and whether to add more.

BC100 The IASB proposes no changes to the exceptions in IFRS 1 as a result of the amendments it proposes to make to IAS 37 because:

(a) IFRS 1 provides no exceptions to the requirements in IAS 37, other than the exemptions from the requirements in IFRIC 1 described in paragraph BC97; and

(b) the amendments proposed in the Exposure Draft would not fundamentally change the requirements in IAS 37 or the procedures or judgements necessary to apply those requirements.

Disclosure—Subsidiaries without public accountability

BC101 Eligible subsidiaries can choose to apply the reduced disclosure requirements in IFRS 19 *Subsidiaries without Public Accountability: Disclosures* instead of the more extensive disclosure requirements in other IFRS Accounting Standards.[6]

5 See paragraph BC63C of the Basis for Conclusions on IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

6 A subsidiary is eligible if:

- it does not have public accountability; and
- it has an ultimate or intermediate parent that produces consolidated financial statements available for public use that comply with IFRS Accounting Standards.

BC102 When the IASB proposes new or amended disclosure requirements for other IFRS Accounting Standards it considers whether to include those requirements in IFRS 19. It judges whether including them would provide useful information to users of eligible subsidiaries' financial statements. In doing so, the IASB:

(a) applies guiding principles set out in paragraph BC33 of the Basis for Conclusions on IFRS 19; and

(b) assesses the costs and benefits of the new or amended disclosure requirements based on the needs of those users.

BC103 The IASB has considered whether to add to IFRS 19 the two disclosure requirements it proposes to add to IAS 37.

BC104 As set out in Appendix B to the Exposure Draft, the IASB proposes to add to IFRS 19 a requirement to disclose the discount rate or rates used in measuring a provision. This proposal reflects:

(a) the guiding principle that information on measurement uncertainties —for example, significant judgements and estimates—is important for eligible subsidiaries;

(b) the fact that IFRS 19 requires disclosure of the discount rates used in measuring other assets and liabilities; and

(c) the IASB's assessment that the costs of disclosing discount rates used would be low, because the information is readily available and not commercially sensitive.

BC105 The IASB proposes not to add to IFRS 19 a requirement to disclose the approach used to determine discount rates. The IASB noted that IFRS 19 does not require disclosure of this information for most other assets and liabilities (the only exception being insurance contract liabilities) and concluded that the costs of providing this information would exceed the benefits to the users of eligible subsidiaries' financial statements.

Consequential amendments to other IFRS Accounting Standards

BC106 As a consequence of its proposals to amend IAS 37, the IASB also proposes amendments to other IFRS Accounting Standards. As set out in Appendix B to the Exposure Draft, it proposes:

(a) to remove from IFRS 3 *Business Combinations* an exception to its recognition principle, as explained further in paragraphs BC107–BC110; and

(b) to make minor amendments to several IFRS Accounting Standards that refer to IAS 37. The aim of these amendments would be to align the wording of the references in those other Standards with the amended wording in IAS 37.

Consequential amendment to IFRS 3

BC107 Two recognition principles underpin the requirements in IFRS 3 for recognising assets and liabilities acquired in a business combination:

(a) at the acquisition date, the acquirer recognises the identifiable assets it has acquired and the liabilities it has assumed, recognising items that meet the definition of an asset or a liability as set out in the *Conceptual Framework*;[7] and

(b) after the acquisition date, the acquirer accounts for those assets and liabilities in accordance with the applicable IFRS Accounting Standard for those items, depending on their nature.[8]

BC108 Currently, the recognition requirements in IAS 37 and IFRIC 21 are not consistent with the *Conceptual Framework*. Some items that meet the definition of a liability in the *Conceptual Framework* do not meet the definition applied in the present obligation recognition criterion in IAS 37. As a result, an acquirer applying the recognition principles in IFRS 3 might recognise a provision on acquisition and then be required to derecognise that provision immediately after the acquisition.

BC109 To avoid this outcome, paragraphs 21A–21C in IFRS 3 provide an exception to the initial recognition principle. The exception applies to liabilities and contingent liabilities that would be within the scope of IAS 37 or IFRIC 21 if they were incurred separately rather than assumed in a business combination. The exception specifies that an entity applies IAS 37 or IFRIC 21 (instead of the *Conceptual Framework*) to determine whether to recognise a liability for those items at the acquisition date.

BC110 As discussed in paragraphs BC34–BC36, the IASB proposes to amend the requirements supporting the present obligation recognition criterion in IAS 37, to align them with the *Conceptual Framework*. It also proposes to withdraw IFRIC 21. These amendments would eliminate the inconsistency between the IFRS 3 recognition principle and IAS 37 recognition criteria, rendering the exception in IFRS 3 redundant. Consequently, the IASB proposes to remove the exception by deleting paragraphs 21A–21C from IFRS 3.

Costs and benefits of the proposed amendments

BC111 The IASB has assessed the likely costs and benefits of possible amendments to IAS 37 throughout the development of the proposals in the Exposure Draft.

BC112 Before deciding to add a project to amend IAS 37 to its work plan, and in determining the project scope and objectives, the IASB identified a list of potential shortcomings in IAS 37. The IASB then sought stakeholder views on whether the benefits of amendments would exceed the costs for each shortcoming. The scope of the project includes only matters on which there was consensus among stakeholders that the benefits would exceed the costs.[9]

7 See paragraphs 10–11 of IFRS 3.

8 See paragraph 54 of IFRS 3.

9 IASB meeting, January 2020, Agenda Paper 22 *Provisions—Project proposal*.

BC113 In reaching its tentative decisions on this project, the IASB considered the costs and benefits of various options for each of the proposed amendments and for the transition requirements. Likely costs and benefits were identified using information gathered from stakeholders and explained in the staff papers prepared for the meetings at which the IASB made its tentative decisions.

BC114 Table 1 sets out the IASB's assessment of the most significant costs and benefits of the amendments proposed in the Exposure Draft. The IASB is publishing the Exposure Draft having reached a view that the benefits would exceed the costs.

Table 1—Likely costs and benefits of the amendments proposed in the Exposure Draft

	Amendment	Likely costs	Likely benefits
(a)	Updated liability definition.	Initial application costs to understand the new definition and its practical implications.	Lower ongoing costs resulting from a single, clearer definition in IFRS Accounting Standards.
(b)	Clearer requirements supporting the present obligation recognition criterion.	Initial application costs to understand the new requirements and their practical implications.	Lower ongoing costs and more consistent application.
(c)	New requirements leading to earlier and progressive recognition of some levies.	Initial application costs to understand the new requirements and change an accounting policy. Higher ongoing application costs, because provisions recognised earlier might be subject to greater measurement uncertainty.	More useful information for investors, helping them to assess an entity's future cash flows.
(d)	Withdrawal of IFRIC 6, IFRIC 21 and two agenda decisions. Addition of their fact patterns to the *Guidance on implementing IAS 37*.	Initial application costs to become familiar with the new structure.	Easier ongoing application resulting from all IAS 37 requirements and guidance being consolidated in one place.

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	Amendment	Likely costs	Likely benefits
(e)	Requirements for threshold-triggered costs.	Initial application costs to change an accounting policy. Higher ongoing application costs, because provisions recognised earlier might be subject to higher measurement uncertainty.	Clearer requirements reducing application costs and promoting more consistent application. More useful information for investors, helping them to assess an entity's future cash flows.
(f)	More specific discount rate requirements.	Initial application costs to change an accounting policy.	Less diversity in practice and less subjectivity in measurements, improving comparability between entities.
(g)	Requirement for an entity to disclose the discount rates it uses and its approach to determining those rates.	Ongoing application costs for entities to provide this additional information. The IASB expects that these costs will not be high because the information is readily available and is not commercially sensitive.	Useful information for investors and increased transparency, improving comparability between entities.

Appendix A—Functions and sources of proposals in paragraphs 14A–16

BCA1 This appendix provides a paragraph-by-paragraph explanation of the proposed amendments to the requirements supporting the present obligation recognition criterion (paragraphs 14A–16).

BCA2 For each of those paragraphs, it provides:

(a) a cross-reference to the source of the proposed requirements, which is typically an existing paragraph in IAS 37 or a paragraph in the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*); and

(b) an explanation of the contribution the paragraph makes to achieving the overall objectives of the amendments, as discussed in paragraphs BC26–BC47.

BCA3 References to IAS 37 and the *Conceptual Framework* use shorthand labels:

(a) IAS 37.x refers to paragraph x of IAS 37; and

(b) CF.4.x refers to paragraph x of Chapter 4 of the *Conceptual Framework*.

Table A1—Paragraph-by-paragraph explanations

Exposure Draft paragraph	Function and source	Contribution to overall aims
14A	Identifies three conditions within the present obligation recognition criterion, reflecting those in CF.4.27.	Replaces the requirement for an obligating event with three distinct conditions.
14B	Defines an 'obligation', using and expanding on the definition in CF.4.29.	Clarifies that the 'no practical ability to avoid' requirement refers to an entity's ability to avoid discharging a responsibility if it obtains specific benefits or takes a specific action, not its ability to avoid obtaining those benefits or taking that action.
14C	Identifies the mechanisms that create obligations using the existing definitions in IAS 37.10.	Links the obligation condition to the definitions of legal and constructive obligations.

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Exposure Draft paragraph	Function and source	Contribution to overall aims
14D	Provides examples of economic benefits and actions, building on those listed in CF.4.44 and some illustrated in the *Guidance on implementing IAS 37*.	Clarifies the meaning of two terms used in describing both the obligation condition (paragraph 14B) and the past-event condition (paragraph 14N).
14E	Retains the first part of IAS 37.20 with minor edits to make the wording consistent with CF.4.29.	Improves clarity and editorial consistency with no substantive changes.
14F	Explains the meaning of 'no practical ability to avoid'. Replaces IAS 37.17(a) with analysis from IFRS Interpretations Committee Agenda Decision *Negative Low Emission Vehicle Credits* (IAS 37). Integrates concepts from CF.4.34. Retains IAS 37.17(b).	Clarifies the circumstances in which an entity has no practical ability to avoid a legal obligation. Retains existing requirements related to constructive obligations.
14G	Retains IAS 37.22.	Clarifies that a law gives rise to an obligation when it has been enacted or is virtually certain to be enacted.
14H	Retains the second part of IAS 37.20.	Explains why a board decision is not enough to give rise to a constructive obligation.
14I–14J	Integrates concepts from CF.4.36–CF.4.37.	Explicitly includes and explains the transfer condition in the definition of a liability.

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Exposure Draft paragraph	Function and source	Contribution to overall aims
14K	Integrates concepts from CF.4.38.	Explains how the transfer condition in the present obligation recognition criterion in paragraph 14(a) of IAS 37 works alongside the probable transfer recognition criterion in paragraph 14(b) of IAS 37.
14L	Develops concepts from CF.4.39(c) (an example of an obligation to transfer an economic resource), and CF.4.47 and CF.4.57 (description of obligations in executory contracts).	Clarifies existing requirements. Explains why an executory contract (or any other type of obligation to exchange economic resources) meets the recognition criteria only if the contract (or other type of obligation) is onerous.
14M	Repeats new paragraph 14A(c).	Introduces the discussion of the past-event condition.
14N	Replaces IAS 37.19 with new requirements using concepts from CF.4.43.	Redescribes the past-event condition.
14O	Adds clarifying details from CF.4.44.	Describes the circumstances in which the past-event condition is met over time.
14P	Specifies application requirements for threshold-triggered costs, interpreting the general requirements proposed in paragraphs 14N–14O.	Promotes consistent application of the general requirements.

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Exposure Draft paragraph	Function and source	Contribution to overall aims
14Q	Specifies requirements for obligations that arise only if an entity takes two or more separate actions. The requirements are based on concepts from CF.4.32. In the *Conceptual Framework*, these concepts are in the section discussing the obligation condition because, like the obligation condition, they apply a 'no practical ability to avoid' threshold. However, they apply that threshold in the context of the past-event condition, so the IASB proposes to include the requirements in the past-event section of IAS 37.	Replaces IFRIC 21 *Levies* with requirements that would result in earlier and progressive recognition of some annual levies and, therefore, more useful information about those levies.
14R	Integrates concepts from CF.4.33, which supports CF.4.32.	Provides further guidance on how to interpret 'no practical ability to avoid' in the past-event condition.
14S–14T	Uses concepts in CF.4.45 to clarify that the enactment of a law or an action that creates a constructive obligation is not sufficient to create a present obligation.	Clarifies the existing requirements. Helps explain that the announcement of a commitment is not sufficient for the entity to recognise a provision, as illustrated in Example 15 Climate-related Commitments in Section C of the proposed amendments to the *Guidance on implementing IAS 37*.

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Exposure Draft paragraph	Function and source	Contribution to overall aims
14U	Retains IAS 37.21, renumbered and with edits to make the terminology consistent with the preceding paragraphs.	Retains the clarification that events (obtaining specific economic benefits or taking a specific action) that do not give rise to a present obligation immediately might do so at a later date.
15–16	Retains the requirements for circumstances in which it is unclear whether the present obligation recognition criterion is met because it is unclear whether specific events occurred or how the law applies to those events. Some text has been reworded.	The rewording ensures that the requirements allow for the possibility that the uncertainty could relate to any of the three conditions in the present obligation recognition criterion. This possibility is shown explicitly in the proposed new decision tree in Section B1 of the *Guidance on implementing IAS 37*.

Appendix B—Non-performance risk—Conceptual considerations

BCB1 The IASB proposes to require an entity to discount a provision at a rate that excludes non-performance risk (see paragraphs BC75–BC80).

BCB2 In reaching this decision, the IASB considered arguments that a rate that includes non-performance risk:

(a) can be justified conceptually and results in information that could be useful to investors; and

(b) can be viewed as consistent with both:

(i) the measurement objective of IAS 37; and

(ii) the requirement in paragraph 47 of IAS 37 to reflect risks 'specific to the liability'.

BCB3 However, the IASB noted it can be argued that a rate that excludes non-performance risk also fulfils these criteria.

BCB4 This appendix explains these observations further.

Table B1—Conceptual justification and information provided to investors

(a) Non-performance risk excluded
If the discount rate for a provision excludes non-performance risk, the measure of the provision tells investors the amount the entity would need to invest in risk-free assets at the reporting date to fund the settlement of a provision that has been measured at its certainty equivalent amount, as described in paragraph BC68(a). Provisions within the scope of IAS 37 have a characteristic that justifies treating them differently from liabilities that arise from exchange transactions. Provisions within the scope of IAS 37 (for example, asset decommissioning obligations) typically do not include an obligation for an entity to pay the counterparty compensation for accepting non-performance risk. By discounting a provision (and hence unwinding the discount) at a rate that excludes non-performance risk, an entity faithfully represents the fact that it does not incur an expense for transferring that risk—that is, it does not have to pay the counterparty a premium for accepting the risk.
(b) Non-performance risk included
If the discount rate for a provision includes non-performance risk, the measure of the provision reflects the economic value of the entity's obligation (and the counterparty's claim), making the provision more comparable with liabilities measured at a market value. The measure of the provision tells investors that the liability is less onerous than an otherwise identical liability that requires the entity to pay a non-performance risk premium. The non-performance risk adjustment in the discount rate tells investors the level of non-performance risk associated with the provision. This risk exists and transfers to the counterparty regardless of whether the entity compensates the counterparty for accepting the risk.

Table B2—Consistency with the measurement objective of IAS 37

(a) Non-performance risk excluded
Paragraph 36 of IAS 37 describes the measurement objective as 'the best estimate of the expenditure required to settle the present obligation'. This amount does not reflect the probability that the entity will fail to settle the obligation.
(b) Non-performance risk included
Paragraph 37 of IAS 37 supplements the measurement objective. It describes the measurement objective as 'the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time'. This amount would reflect the probability that the entity will fail to settle the obligation.

Table B3—Requirement to reflect risks 'specific to the liability'

(a) Non-performance risk excluded
It can be argued that non-performance risk is not specific to the liability because it does not depend solely on the characteristics of the liability. It also depends on the credit standing of the entity that owes the liability.
(b) Non-performance risk included
It can be argued that non-performance risk is specific to the liability because it depends in part on the characteristics of the liability—for example, where the liability would rank relative to other liabilities in a liquidation.

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