
Accounting Standards Advisory Forum meeting

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Accounting Standards Advisory Forum, July 2024, Agenda paper 3E

This paper was discussed at the International Accounting Standards Board's (IASB's) April 2024 meeting as [Agenda Paper 22E](#). Agenda papers referred to in this paper are other agenda papers for the IASB's April 2024 meeting, unless otherwise noted.

Indicative drafting for amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

This paper contains no questions for the IASB—it is for reference only.

Abbreviations in staff notes:

CFx.xx	=	Paragraph x.xx of the <i>Conceptual Framework for Financial Reporting</i>
IAS_37.xx	=	Paragraph xx of IAS 37

Definitions

10 The following terms are used in this Standard with the meanings specified:

A provision is a liability of uncertain timing or amount.

A liability is a present obligation of the entity ~~arising from to~~ transfer an economic resource as a result of past events, ~~the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.~~⁺

Liability definition
CF4.2

~~An obligating event is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation. An obligation is a responsibility that an entity has no practical ability to avoid.~~

Obligating event definition

Deletion explained in Table 3 in the appendix to Paper 22A.

A legal obligation is an obligation that derives from:

- (a) a contract (through its explicit or implicit terms);
- (b) legislation; or
- (c) other operation of law.

Obligation definition
Based on definition in CF4.29.

A constructive obligation is an obligation that derives from an entity's actions where:

- (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and

⁺ ~~The definition of a liability in this Standard was not revised following the revision of the definition of a liability in the *Conceptual Framework for Financial Reporting* issued in 2018.~~

- (b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

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Recognition

Provisions

14 A *provision* shall be recognised when:

- (a) an entity has a present *obligation* (legal or constructive) to transfer an economic resource as a result of a past event;
- (b) it is probable that ~~an outflow of resources embodying economic benefits the entity~~ will be required to transfer an economic resource to settle the obligation; and
- (c) a reliable estimate can be made of the amount of the obligation.

See Table 2 in the appendix to Agenda Paper 22A.

If these conditions are not met, no provision shall be recognised.

Present obligation to transfer an economic resource as a result of a past event

14A One of the criteria for recognising a provision is that the entity has a present obligation (legal or constructive) to transfer an economic resource as a result of a past event, that is an obligation that meets the definition of a liability. There are three conditions within that definition:

- (a) a strength condition—the entity has an obligation;
- (b) a nature condition—the obligation is to transfer an economic resource; and
- (c) a timing condition—the obligation is a present obligation that exists as a result of a past event.

CF4.27

Replaces definition of obligating event.

Labels for the three conditions explained in paragraphs 20–21 of Agenda Paper 22A

Strength condition—an obligation

14B The first condition is that the entity has an obligation. An obligation derives from a mechanism that:

- (a) imposes a responsibility on the entity; and
- (b) is strong enough in its effect that entity has no practical ability to avoid the responsibility.

Links the **CF4.29** definition of an obligation to the mechanism creating it.

14C- The mechanism imposing the responsibility could be:

- (a) legal—for example, a contract or legislation; or
- (b) constructive—the entity’s established pattern of past practice, its published policies or a sufficiently specific current statement.

Uses definitions of legal and constructive obligations in IAS37.10.

14D ~~20~~ An obligation is always ~~involved~~ owed to another party ~~to whom the obligation is owed~~. The other party could be a person or another entity, a group of people or other entities, or society at large. It is not necessary, ~~however~~, to know the identity of the party to whom the obligation is owed ~~—indeed the obligation may be to the public at large~~.

First half of paragraph 20, moved up from past event section.

Edited to align wording with CF4.29

~~14E 17~~ ~~A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only~~ An entity has no practical ability to avoid a responsibility:

Paragraph 17, moved up from past event section.

(a) in the case of a legal obligation where:

(i) ~~_____ the settlement of the obligation can be enforced by law~~ the other party has a legal right to take action against the entity if it fails to discharge the responsibility—for example to ask a court to enforce settlement, to charge a the entity a financial penalty or to deprive the entity of access to economic benefits; and

Explained in Table 4 of the appendix to Agenda Paper 22A.

~~(ii)~~ as a result, the economic consequences for the entity of not discharging the responsibility are expected to be significantly more adverse than the economic consequences of discharging it; or

CF4.34

(b) in the case of a constructive obligation, where ~~the event (which may be an action of the entity)~~ creates valid expectations in other parties that the entity will discharge the ~~obligation~~ responsibility.

By definition, the event must be an action of the entity (see definition of constructive obligation in IAS37.10).

14F-20 Because an obligation always involves a commitment to another party, it follows that a management or board decision does not give rise to a constructive obligation at the end of the reporting period unless the decision has been communicated before the end of the reporting period to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities.

Second half of paragraph 20, moved up from past event section.

14G A conclusion that it is appropriate to prepare an entity's financial statements on a going concern basis also implies a conclusion that the entity has no practical ability to avoid a transfer that could be avoided only by liquidating the entity or by ceasing to trade.

CF4.33
Possibly useful for IAS 37 because some levies could be avoided only by ceasing to trade.

Paragraphs 15 and 16 have been moved down, to become paragraphs 22A and 22B.

Nature condition—transfer of an economic resource

16A The second condition is that the obligation is to transfer an economic resource. To satisfy this criterion, the obligation must have the potential to require the entity to transfer an economic resource to another party.

CF4.37
and Table 5 in Agenda Paper 22A.

16B For that potential to exist, it does not need to be certain, or even likely, that the entity will be required to transfer an economic resource—the transfer may, for example, be required only if a specified uncertain future event occurs. However, the probability of the entity being required to transfer an economic resource will affect the decision on whether the entity recognises a provision and, if not, whether it discloses a contingent liability (see paragraphs 14(b) and 23).

Applies **CF4.38**
Helps to clarify when and how the 'probable outflows criterion' comes into play.

~~16C~~ ~~An obligation to exchange economic resources with another party is not an obligation to transfer an economic resource to that other party unless the terms of the exchange are unfavourable to the entity—for example, if the terms of an executory contract are onerous.~~

CF4.39(c),
CF4.47 and
CF4.57

Provides a basis for requirements for onerous contracts (IAS37.66–IAS37.69) and conclusions in Illustrative Examples 6 and 11.

~~Past event~~ **Timing condition—a present obligation as a result of a past event**

18 Financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an entity’s statement of financial position are those that exist at the end of the reporting period.

~~19~~ ~~It is only those obligations arising from past events existing independently of an entity’s future actions (ie the future conduct of its business) that are recognised as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the entity. Similarly, an entity recognises a provision for the decommissioning costs of an oil installation or a nuclear power station to the extent that the entity is obliged to rectify damage already caused. In contrast, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no~~

Replaced by new paragraphs 19A-19C. See Table 6 in Agenda Paper 22A.

~~present obligation for that future expenditure and no provision is recognised.~~

19A An entity has a present obligation as a result of a past event only if the entity:

- (a) has obtained economic benefits or taken an action; and
- (b) as a consequence, will or may have to transfer an economic resource it would not otherwise have had to transfer.

CF4.43
Replaces IAS37.19

19B The economic benefits obtained could include, for example, goods or services. The action taken could include, for example, operating a particular business or operating in a particular market. If economic benefits are obtained, or an action is taken, over time, the resulting present obligation may accumulate over that time.

CF4.44
Useful for levies.

19C In some situations, an entity will have to transfer an economic resource only if it takes two (or more) separate actions, with the requirement to transfer an economic resource being a consequence of taking both (or all) these actions. The entity incurs a present obligation when it takes the first action if it has no practical ability to avoid taking the other action (or all the other actions).

CF4.32
(Redrafted to articulate in a way that stakeholders seemed to find more understandable.)

19D In some situations, an entity will have to transfer an economic resource only if a measure of its activity in a period (the measurement period) exceeds a specified threshold. In such situations, a present obligation arises as the entity performs the activity that contributes to the total amount on which the transfer is measured. At any date within the measurement period, the amount of the present obligation is a portion of the total expected transfer for the measurement period, the portion being the amount attributable to the activity performed to date.

See Agenda Paper 22B

Example on next page to help explain requirement
↓

Example

Legislation requires an entity to pay a levy of 2 per cent of the revenue it generates in excess of 50 million currency units in a calendar year. A present obligation for the levy accumulates as the entity generates revenue in that year. The amount of the obligation at any date within the year is a portion of the total levy forecast for the year, that portion being the amount attributable to the revenue generated to date. The entity recognises a provision if it is probable that the entity will be required to pay a levy (see paragraph 14(b)) and a reliable estimate can be made of the amount of the obligation (see paragraph 14(c)).

Perhaps include an example like this?
The requirement is quite abstract and a concrete example might help clarify it. There is another example like this in IAS 37, below paragraph 38, to explain the measurement of an expected value.

- 21 An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law or because an act (for example, a sufficiently specific public statement) by the entity gives rise to a constructive obligation. For example, when environmental damage is caused there may be no obligation to remedy the consequences. However, the causing of the damage will ~~become an obligating event~~ give rise to a present obligation when a new law requires the existing damage to be rectified or when the entity publicly accepts responsibility for rectification in a way that creates a constructive obligation.

21A Conversely:

- (a) the enactment of a new law is not in itself sufficient to give an entity a present legal obligation. A present legal obligation arises only when, as a consequence of obtaining economic benefits or of taking an action to which the law applies, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer.
- (b) having an established pattern of past practice, publishing a policy, or making a statement is not in itself sufficient to create a present constructive obligation for an entity. A present constructive obligation arises only when, as a consequence of obtaining economic benefits or taking an action to which the practice, policy or statement applies, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer.

CF4.45

A net zero transition commitment example will illustrate this point.

- 22 Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted as drafted. For the purpose of this Standard, such an obligation is treated as a legal obligation. Differences in circumstances surrounding enactment make it impossible to specify a single event that would make the enactment of a law virtually certain. In many cases it will be impossible to be virtually certain of the enactment of a law until it is enacted.

Uncertainty about the existence of an obligation meeting the definition of a liability

1522A In rare cases it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the end of the reporting period.

1622B In almost all cases it will be clear whether a past event has given rise to a present obligation. In rare cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in an obligation. In such a case, an entity determines whether an obligation exists at the end of the reporting period by taking account of all available evidence, including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the reporting period. On the basis of such evidence:

- (a) where it is more likely than not that a present obligation exists at the end of the reporting period, the entity recognises a provision (if the recognition criteria are met); and
- (b) where it is more likely that no present obligation exists at the end of the reporting period, the entity discloses a contingent liability, unless the possibility of ~~an outflow of resources embodying economic benefits~~ the entity being required to transfer an economic resource is remote (see paragraph 86).

Paragraphs 15 and 16 in IAS 37 address existence uncertainty. We think they need to sit outside the sections discussing the individual conditions, so suggest moving them below these sections.

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Application of the recognition and measurement rules

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Restructuring

70 The following are examples of events that may fall under the definition of restructuring:

- (a) sale or termination of a line of business;
- (b) the closure of business locations in a country or region or the relocation of business activities from one country or region to another;
- (c) changes in management structure, for example, eliminating a layer of management; and
- (d) fundamental reorganisations that have a material effect on the nature and focus of the entity's operations.

71 A provision for restructuring costs is recognised only when the general recognition criteria for provisions set out in paragraph 14 are met. Paragraphs 72–83 set out how the general recognition criteria apply to restructurings.

72 A **present obligation to restructure for restructuring costs** arises only when an entity:

- (a) **has a detailed formal plan for the restructuring identifying at least:**
 - (i) **the business or part of a business concerned;**

Suggestions for edits to the requirements for restructuring provisions are explained in Table 7 in the appendix to Agenda Paper 22A.

- (ii) **the principal locations affected;**
 - (iii) **the location, function, and approximate number of employees who will be compensated for terminating their services;**
 - (iv) **the expenditures that will be undertaken; and**
 - (v) **when the plan will be implemented; and**
- (b) **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.**
- 73 Evidence that an entity has started to implement a restructuring plan would be provided, for example, by:
- (a) dismantling plant or selling assets, or
 - (b) by the public announcement of the main features of the plan. ~~A public announcement of a detailed plan to restructure constitutes a constructive obligation to restructure only if it is,~~ made in such a way and in sufficient detail (ie setting out the main features of the plan) that it gives rise to valid expectations in other parties such as customers, suppliers and employees (or their representatives) that the entity will carry out the restructuring.
- 74 ~~For Announcing the main features of a plan ~~to be sufficient to give rise to a constructive obligation when communicated~~ to those affected by it,~~ is sufficient to create a valid expectation that the entity will carry out the plan only if ~~its~~ implementation ~~needs to be~~ planned to begin as soon as possible and to be completed in a timeframe that makes significant changes to the plan unlikely. If it

is expected that there will be a long delay before the restructuring begins or that the restructuring will take an unreasonably long time, it is unlikely that the plan will raise a valid expectation on the part of others that the entity is at present committed to restructuring, because the timeframe allows opportunities for the entity to change its plans.

- 75 A management or board decision to restructure taken before the end of the reporting period does not give rise to ~~a constructive~~an obligation at the end of the reporting period unless the entity has, before the end of the reporting period:
- (a) started to implement the restructuring plan; or
 - (b) announced the main features of the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will carry out the restructuring.

If an entity starts to implement a restructuring plan, or announces its main features to those affected, only after the reporting period, disclosure is required under IAS 10 *Events after the Reporting Period*, if the restructuring is material and non-disclosure could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

- 76 Although ~~a constructive~~an obligation is not created solely by a management decision, an obligation may result from other earlier events together with such a decision. For example, negotiations with employee representatives for termination payments, or with

purchasers for the sale of an operation, may have been concluded subject only to board approval. Once that approval has been obtained and communicated to the other parties, the entity has ~~an~~ constructive obligation ~~to restructure~~ for restructuring costs, if the conditions of paragraph 72 are met.

77 In some countries, the ultimate authority is vested in a board whose membership includes representatives of interests other than those of management (eg employees) or notification to such representatives may be necessary before the board decision is taken. Because a decision by such a board involves communication to these representatives, it may result in ~~a~~ constructive ~~an~~ obligation ~~to restructure~~ for restructuring costs.

78 No obligation arises for the sale of an operation until the entity is committed to the sale, ie there is a binding sale agreement.

79 Even when an entity has taken a decision to sell an operation and announced that decision publicly, it cannot be committed to the sale until a purchaser has been identified and there is a binding sale agreement. Until there is a binding sale agreement, the entity will be able to change its mind and indeed will have to take another course of action if a purchaser cannot be found on acceptable terms. When the sale of an operation is envisaged as part of a restructuring, the assets of the operation are reviewed for impairment, under IAS 36. When a sale is only part of a restructuring, a constructive obligation can arise for the other parts of the restructuring before a binding sale agreement exists.

80 A restructuring provision shall include only **obligations for the direct expenditures arising from the restructuring, which are those that are both:**

A provision is defined as an obligation, not as expenditure.

- (a) necessarily entailed by the restructuring; and
- (b) not associated with the ongoing activities of the entity.

80A A restructuring provision could include, for example:

- (a) legal or constructive obligations to pay termination benefits to employees whose roles are made redundant by the restructuring—to the extent that the obligations arise from past employment; or
- (b) contractual obligations to pay penalties for cancelling supply contracts the entity entered into before the end of the reporting period.

Table 7 in the appendix to Agenda Paper 22A explains why examples might help.

We think an employee benefits example is consistent with IAS 19 *Employee Benefits* requirements:

- IAS 19 encompasses both legal and constructive obligations for employee benefits.
- IAS 19 defines the term 'termination benefits'.
- IAS19.165 requires an entity to recognise a liability for termination benefits at the earlier of when it can no longer with an offer of benefits and when the entity recognises costs for a restructuring that is within the scope of IAS 37 and involves the payment of termination benefits.

81 A restructuring provision does not include such costs as:

- (a) retraining or relocating continuing staff;
- (b) marketing; or
- (c) investment in new systems and distribution networks.

These expenditures relate to the future conduct of the business, and are not ~~liabilities for restructuring~~ present obligations at the end of the reporting period. Such expenditures are recognised on the same basis as if they arose independently of a restructuring.

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