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The IASB Research Project Provisions Cover Note

Objective

- 1 The objective of this session is to obtain EFRAG TEG and EFRAG CFSS members' views on a possible project to make targeted improvements to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Background

- 2 When IAS 37 was issued in 1998, it filled a significant void. IAS 37 restricted provisions to items meeting the definition of a liability whereas before its issue, entities could make provisions for future costs that were not present obligations, what provided significant scope for earnings manipulation.
- 3 However, IAS 37 was criticised for clarity, some internal inconsistencies, and not being aligned with other IFRS Standards, regarding the recognition criteria for provisions. For example, IAS 37 is not clear how unavoidable an obligation must be. Furthermore, paragraphs 10 and 19, which defines the recognition criteria for provisions, seems to be contradictory. In consequence, the IFRS Interpretations Committee, has been requested to clarify those criteria, and published two IFRIC Interpretations:
 - (a) IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment*; and
 - (b) IFRIC 21 *Levies*.However, these IFRIC Interpretations have not clarified IAS 37 requirements and have been criticised as appearing inconsistent with other IAS 37 requirements. Moreover, IFRIC 21 results in some of the recurring periodic levies being recognised as expenses at a single point in time.
- 4 In 2002, the IASB started a project to amend IAS 37. That project aimed to align the recognition criteria in IAS 37 with IFRS 3 *Business Combinations*, and to eliminate some differences between requirements for restructuring costs in IFRS Standards and US GAAP. However, the respondents to the IASB's exposure drafts, issues in 2005 and 2010, expressed significant opposition to the proposals. EFRAG's comment letter regarding the 2010 exposure draft is available [here](#). In response to the comments, the IASB decided to suspend the project pending completion of its project to revise the Conceptual Framework.
- 5 Following the 2015 Agenda Consultation, the IASB added a new research project to review the requirements of IAS 37 to its research pipeline. The project is intended to gather evidence to help the IASB decide:
 - (a) whether to take on an active project to amend aspects of IAS 37; and

- (b) if so, what the scope of the active project should be.
- 6 In 2018, the IASB decided to restart the research project on provisions after the IASB issued the revised Conceptual Framework and reactivated the project in December.
- 7 The IASB has not yet made any decisions regarding whether and how IAS 37 should be amended.
- 8 Recently, the IASB has started a narrow-scope amendment project to clarify the requirements in IAS 37 regarding the assessment of whether, in a contract, the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. That project is planned to be presented in Session 15 of today's meeting.

The current status of the IASB research project

- 9 Currently, the IASB Staff seeks constituents' views on the possible scope of the project to make targeted improvements to IAS 37, and proposes the following main aspects for discussion:
 - (a) aligning the definition of liability in IAS 37, and supporting guidance, with the Conceptual Framework; the possible amendments could replace IFRIC 21 – the issue identified by the IASB Staff relates to the recognition of obligation that has arisen from an entity's past actions but is also dependent on the entity's future actions;
 - (b) clarifying which costs to include in the measure of a provision – the issues identified by the IASB Staff include the lack of clarity about which costs should be included as part of the 'expenditure required to settle' an obligation to provide goods or services, and whether an entity should include costs payable to third parties, such as the legal costs associated with settling a lawsuit; and
 - (c) specifying whether the rate at which provisions are discounted should reflect the entity's own credit risk.
- 10 Furthermore, the IASB staff seeks views on whether the following aspects create significant application problems, and whether they should be addressed in the project:
 - (a) adjustment of the measurement of provisions for risks - IAS 37 does not specify the objective of the risk adjustment, and it does not describe the circumstances in which a risk adjustment is required or explain how the adjustment should be measured;
 - (b) onerous contracts – the identified problems include the following issues:
 - (i) whether the phrase 'economic benefits expected to be received under a contract' should be interpreted narrowly i.e. they should include only the economic benefits to which the entity becomes directly entitled under the contract, or more broadly i.e. they should include other expected indirect benefits, for example access to future profitable contracts;
 - (ii) how an entity should measure the cost of fulfilling a contract if the contract will be fulfilled using the entity's existing assets and those assets are carried at an amount other than cost;
 - (iii) lack of the guidance on the circumstances in which contracts should be combined or segmented.
 - (c) Recognition threshold for reimbursement rights – this includes guidance on situations in which an entity's right to reimbursement for a recognised liability is virtually certain, receipt is highly probable and measurement uncertainty is

low, but no reimbursement asset can be recognised because receipt is not virtually certain; and

- (d) Contingent assets in the context of the events after the reporting period – the issue relates to the apparent inconsistency between the requirements for plaintiffs and those for defendants and results in a court ruling or settlement of a court case being treated by a plaintiff as an ‘non-adjusting event’.

Questions for EFRAG TEG and EFRAG CFSS members

- 11 Do you agree that the three main aspects, mentioned in paragraph 9, above should be considered for targeted improvements?
- 12 Do you think any of the four other aspects, mentioned in paragraph 10 above, give rise to significant problems that could be resolved by amending IAS 37 within a reasonable timescale? If so, what problems are you aware of in practice and what amendments would you recommend in order to resolve them?
- 13 Do IAS 37 requirements give rise to other application issues?

Agenda Papers

- 14 In addition to this cover note, agenda paper 14-02 – *ASAF Paper 06 Provisions for background only* – has been provided for the session.