In brief

Recognising the future: a brief look at the proposed amendments to IAS 37

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Key Points

- The IASB has proposed targeted improvements to IAS 37, 'Provisions, Contingent Liabilities and Contingent Assets'.
- The proposals clarify how entities assess when to record provisions and how to measure them.
- The proposals also aim to provide better information to users of financial statements by enhancing comparability and transparency in the reporting of provisions.
- The most likely impact will be on entities that have long-term decommissioning obligations or are subject to levies.

What is the issue?

In recent years, the IASB has received feedback from stakeholders about certain application issues surrounding IAS 37: stakeholders have had difficulties in applying the IAS 37 recognition criteria to certain complex transactions; investors have felt that the current recognition guidance resulted in unsatisfactory outcomes for some levies; and there was a lack of clarity over some measurement requirements for provisions.

To address these issues, the IASB published the Exposure Draft: Provisions—Targeted Improvements to amend IAS 37. The proposed amendments would consolidate guidance on recognising and measuring provisions under IAS 37, replacing IFRIC 6, 'Liabilities arising from Participating in a Specific Market – Waste Electrical and Electrical Equipment' and IFRIC 21 'Levies'.

The key proposed amendments are as follows:

- improving one of the criteria for recognising a provision – specifically, the requirement for a present obligation as a result of a past event;
- changes in the guidance for measuring provisions – specifically, clarifying what costs should be included in measuring a provision, and improving the guidance on determining the discount rate used for measuring long-term provisions; and
- updates to the accompanying guidance on implementing IAS 37 to reflect these proposed amendments.

The IASB is currently requesting feedback on the proposals, with a deadline for comments of 12 March 2025.

PwC Observation
We support the overall objective to improve the clarity and applicability of IAS 37 through the proposed amendments; and we are, on balance, supportive of those amendments. We believe that the amendments are principles-based, that they address many practical application issues and potential areas of confusion, and that they will benefit both preparers and users of financial statements. For further details on PwC's views on the IASB's proposals, refer to our comment letter.

What is the impact and for whom?

The proposed amendments to IAS 37 are generally applicable to all entities, because most entities have liabilities that are provisions. The amendments are expected to have the greatest impact on entities that are subject to levies or that have significant long-term provisions. Levies can take many forms – for example, as a mechanism for governments to indirectly tax entities, or as an incentive for entities to take specific climate-related actions.

Recognition

The IASB proposes to amend the recognition criteria for present obligations, to reflect the principles and definitions in the Conceptual Framework. The proposals break down the present obligation recognition criteria into three components:

1. Does the entity have an obligation?

   Under the proposed guidance, an entity has an obligation if (a) a legal or constructive mechanism imposes a responsibility on the entity, (b) that responsibility is owed to another party, and (c) the entity has no practical ability to avoid discharging that responsibility.

2. Is the obligation to transfer an economic resource?

   The proposed guidance clarifies that a transfer is not the same as an exchange of resources, unless the exchange is unfavourable. For example, an obligation to pay cash in exchange for receiving goods from a supplier is an exchange of resources and not an obligation to transfer an economic resource, unless the contract is onerous.

3. Is the present obligation a result of a past event?

This is one of the key changes. The proposals suggest that a past event occurs if the entity either (a) obtains a benefit, or (b) takes an action that triggers the requirement discussed in (1) above. This might be over time, if an entity obtains benefits over time or takes multiple actions over time. The change will result in some provisions being recognised earlier and/or more progressively, providing more timely and useful information to stakeholders. This will be especially relevant for entities dealing with levies and threshold-triggered costs.

PwC Observation
Assessing an entity's practical ability to avoid discharging a responsibility We think that the proposed guidance on an entity's practical ability to avoid discharging a responsibility should be reconsidered more holistically. For example, it currently does not provide clear guidance around how detection risk is considered in the obligation condition. We believe that detection risk should not be taken into account in the recognition of liabilities under IAS 37, but it should instead be considered in the measurement of the liability. Also, the way in which economic consequences should be considered in the identification of both legal and constructive obligations could be improved. We provide a recommendation for the redrafting of this guidance in our comment letter. *Past-event condition* Whilst we agree with the concepts, we are concerned that the current drafting might be confusing and difficult to apply. In our comment letter, we recommend redrafting the paragraphs as a single principle that would be clearer to apply and would make the requirement neutral as to whether the entity has control over the related action(s) that trigger the obligation. We also suggest three examples that could be used to illustrate how the principle should be applied to various situations, to enhance understandability of the requirements.

Measurement – discount rates

The IASB proposes requiring the use of a risk-free rate that excludes 'non-performance risk' when discounting long-term provisions. Non-performance risk is a premium added to the discount rate to represent the entity's own credit risk that the entity will not be able to settle the provision. Additional disclosures are also proposed. The removal of non-performance risk from discount rates would result in some provisions becoming larger. This proposed change aims to standardise the discount rates used by entities, enhancing comparability and transparency. Entities with material long-term decommissioning liabilities, such as those in the energy, oil and gas, mining and telecommunications sectors, are likely to be the most affected.

PwC Observation
We agree with the measurement objective of discounting provisions with a rate that excludes non-performance risk, because we think that, in most cases, the entity will satisfy the obligation rather than pay a third party to take responsibility for settling the obligation. However, we note that a directly observable risk-free rate is typically not available, and entities will need to continue to apply judgement in estimating an appropriate risk-free rate for discounting. There is potential to address this diversity more effectively by including requirements similar to the guidance in IAS 19. We recommend discounting long-term provisions using a discount rate based on market yields on high-quality corporate bonds or government bonds as the most effective cost-benefit solution.

Measurement – costs to include

The IASB proposes clarifying that the costs included in measuring a provision should comprise both the incremental costs of settling that obligation and an allocation of other direct costs. This change would result in some provisions becoming larger, because more costs are included in their measurement. For example, legal provisions would include not only payments to the claimant but also an allocation of internal legal department payroll costs. This would ensure that entities apply a consistent measurement approach, aligning the costs considered for both measuring provisions and identifying onerous contracts.

PwC Observation
We think that it would be beneficial for the Board to specify whether the costs to be included in the measurement of a provision include any associated goods or services that must be procured in the future to settle the obligation – for example, whether the anticipated future legal fees directly related to a legal case might be included in the measurement of the provision for settlement. We note that current practice is mixed in this regard. We can see conceptual merit for either including or excluding such costs, but the Board could eliminate diversity in practice by deciding which of the two approaches should be followed.

Next steps

The IASB will consider comment letters and other feedback on the proposals in the exposure draft. If the proposals (or some amended form thereof) are issued, we do not expect the proposals to become effective before 2027.

Where do I get more details?

For further details on PwC's views on the IASB's proposals, refer to our comment letter. Further insights and guidance will be published on Viewpoint as the project progresses. For more information, please contact Beate Butollo or Ulf Kuehle.

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