

IPSASB

International Public
Sector Accounting
Standards Board®

AGENDA ITEM 9

OVERVIEW OF IASB PROJECT: PROVISIONS – TARGETED IMPROVEMENTS

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Sayja Barton, Principal

Washington D.C., USA



Three aspects targeted for improvement

Recognition

- Clearer requirements on when to recognize a provision

Measurement

- Clearer and tighter requirements for discount rates used in measuring long-term provisions

Measurement

- Explicit requirement on costs to include in the measure of a provision

PROPOSED AMENDMENTS RELATED TO RECOGNITION

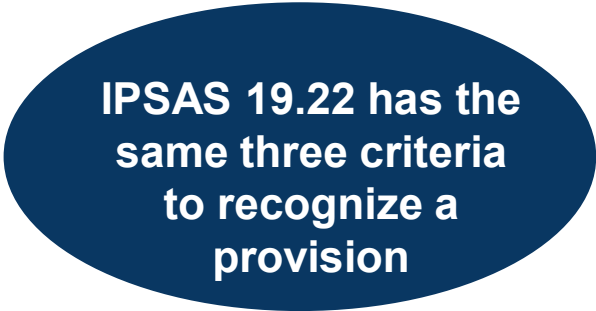
Current IAS 37 criteria for recognizing a provision

- Under IAS 37.14 three criteria must be met to recognize a provision:

- 1) present obligation as a result of a past event
- 2) probable outflow of resources
- 3) reliable estimate can be made



Problematic to apply



**IPSAS 19.22 has the
same three criteria
to recognize a
provision**

Problems with present obligation criterion

Requirements unclear:

- First criterion mixes two conditions – obligation condition & past event condition
- Obligation condition difficult to apply to some newer regulations (e.g. climate related regulations that are enforced via economic incentives or offering novel settlement options)



Outcomes unsatisfactory:

- Obligations for annual levies recognized late and at point in time



Led to requests to IFRIC

- Resulted in IFRIC 6 and IFRIC 21
- Agenda Decision – Negative Low Emission Vehicle Credits

Investor requests for more useful information

Proposals to improve present obligation criterion

- 1) Update definition of a liability
- 2) Align the wording of the present obligation recognition criterion with the updated definition of a liability
- 3) Remove the term ‘obligating event’ and adding three conditions within the present obligation recognition criterion
- 4) Add requirements for threshold-triggered costs
- 5) Improve wording of ‘restructuring costs’
- 6) Update Implementation Guidance

1 & 2 - Update liability definition & wording of recognition criterion

- Update definition of a liability in IAS 37 to align it with the definition in the Conceptual Framework
 - *A liability is a present obligation of the entity to transfer an economic resource as a result of arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.*
- Amend present obligation recognition criteria in IAS 37.14(a) so it aligns with the updated definition of a liability
 - *an entity has a present obligation (legal or constructive) to transfer an economic resource as a result of a past event (paragraphs 14A–16)*

1 & 2 - Update liability definition & wording of recognition criterion – IPSAS

- IPSASB previously completed limited scope update project to update definition of a liability and terminology in Chapter 5 of IPSAS Conceptual Framework
- IPSAS 19 does not include the definition of a liability
- However, IPSAS 19 still refers to “outflow of resources” instead of the new wording “transfer of resources” that is used in the IPSAS Conceptual Framework
- The present obligation recognition criteria in IPSAS 19.22(a) currently does not align with the updated definition of a liability in the IPSAS Conceptual Framework

3 – Revisions related to ‘obligating event’

- Currently IAS 37.17 provides the requirements relating to ‘obligating events’
- Proposal is to remove these requirements and replace them with a requirement to meet three distinct conditions:

A) Obligation condition

- The entity has an obligation

B) Transfer condition

- The nature of the entity’s obligation is to transfer an economic resource

C) Past-event condition

- The entity’s obligation is a present obligation that exists as a result of a past event

3A – Obligation condition

An entity has an obligation if:

- A mechanism is in place that imposes a responsibility on the entity if it obtains specific benefits or takes a specific action;
- The entity owes that responsibility to another party; and
- The entity has no practical ability to avoid discharging the responsibility if it obtains the specific economic benefits or takes the specific action

Mechanism could be legal or constructive

Entity does not need to know the identity of the party

No practical ability to avoid discharging = no realistic alternative to settling

3B – Transfer condition

- For the transfer condition to be met, the obligation must have the potential to require the entity to transfer an economic resource to another party.

Note obligations arising under executory contracts are not obligations to transfer an economic resource unless the contract is onerous.

- The condition requires such potential to exist. It does not need to be certain or even likely that the entity will be required to transfer an economic resource.

Note the probability of a transfer does not affect whether the ‘transfer condition’ of the present obligation recognition criteria is met. However, IAS 37.14(b) requires the transfer of economic resources to settle the obligation to be probable.

3C – Past-event condition

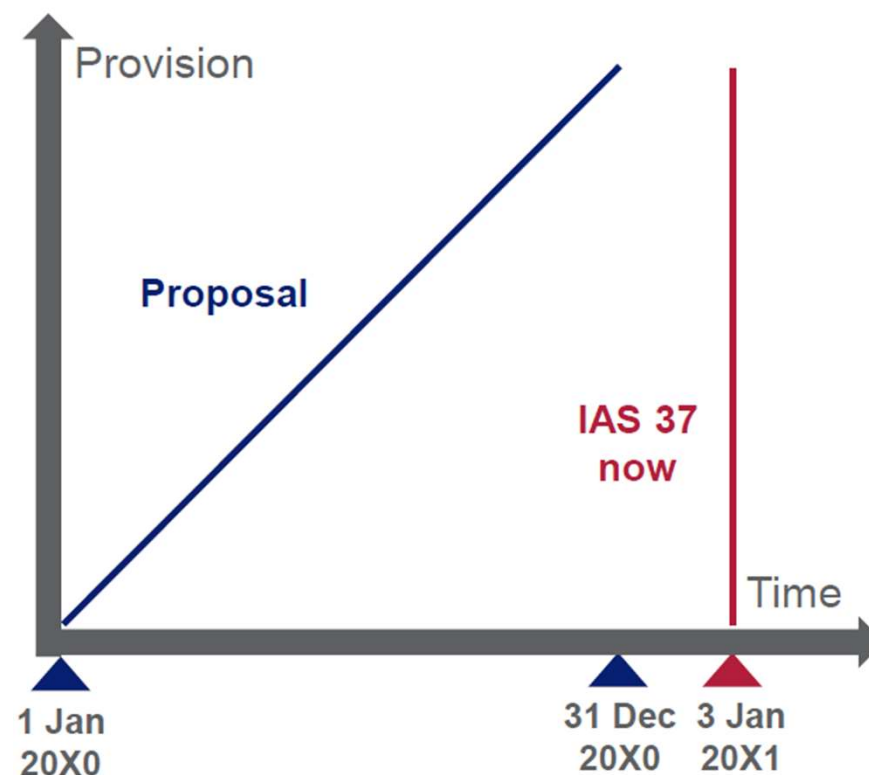
- Entity has obtained the specific economic benefits or taken the specific action; and
- As a consequence, will or may have to transfer an economic resource it would not otherwise have had to transfer
 - Entity must have taken first action and have no practical ability to avoid remaining actions

3C – Past-event condition - Implications

- Levy triggered when entity generates revenue in a market in 20X1
- Levy is 1% of revenue generated in 20X0
- Entity generates revenue evenly throughout 20X0, and in 20X1 starts to generate revenue on 3 January 20X1
- Throughout 20X0, management judges entity has no practical ability to exit market before 20X1

Two separate actions of entity:

- 1) Generates revenue in 20X0
- 2) Starts to generate revenue in 20X1

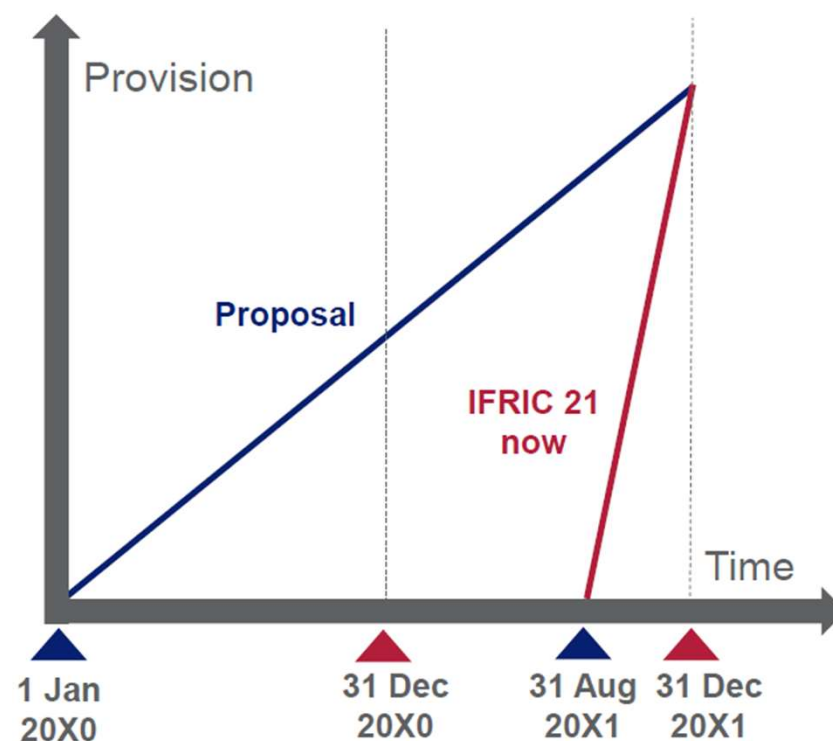


4 – Add requirements for threshold-triggered costs

- Present obligation accumulates as entity conducts activity that contributes to total on which cost is calculated
- Present obligation is portion of total expected obligation – the portion attributable to activity to date
- Provision is recognized if another recognition criteria are met:
 - 1) Probable transfer (i.e. probable that activity will exceed threshold); and
 - 2) Amount can be reasonably estimated

4 – Add requirements for threshold-triggered costs - Implications

- Levy payable if revenue exceeds CU200 million in two-year period— 1 Jan 20X0 to 31 Dec 20X1
- Levy = 1% of revenue above threshold
- Management forecasts revenue of CU10 million / month (CU240 million in 2-year period)
- Actual revenue equals forecast—crossing threshold on 31 August 20X1



5 & 6 – Other Changes

- Improved wording of ‘restructuring costs’
- Updated implementation guidance (added new and revised existing examples)

6 – Update Implementation Guidance

- Update and expand decision tree
- Add new illustrative examples base on fact patterns of:
 - IFRIC 6 Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment
 - Various levies, including some like those in examples accompanying IFRIC 21
 - IFRIC Agenda Decision Negative Low Emission Vehicle Credits
 - IFRIC Agenda Decision Climate-related Commitments
- Revised illustrative examples so they assess fact pattens using three new conditions for the present obligation recognition criterion

PROPOSED AMENDMENTS RELATED TO MEASUREMENT

Measurement 1 – Discount Rates

Proposed requirements

- Discount expenditures at a rate that reflects:
 - Time value of money **as represented by a risk-free rate**; and
 - **Risks in expenditure required to settle obligation** if not reflected in estimates of cash flows, but
 - **Not** non-performance risk
- **Disclose** rates used and approach used to determine the rates

Measurement 2 – Costs to Include

Proposed clarification

- Expenditure = cost that 'related directly' to obligation

Incremental
costs of
settling that
obligation

+

Allocation of other costs
that relate directly to
settling obligations of that
that type

POTENTIAL IMPACT FOR IPSAS

Potential Impact of Similar Proposals for IPSAS

- Updating terminology around liabilities in IPSAS 19 (and other IPSAS standards) to match the updated liability definition in the IPSAS Conceptual Framework would be beneficial
- Similar clarifications of the three aspects of recognition and measurement guidance would be a useful addition to IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*
- While not all of the new illustrative examples added to IAS 37 would be relevant for public sector entities, restructuring existing implementation guidance examples to analyze provisions in the context of the three conditions would be helpful for users of IPSAS
- Maintaining alignment with IFRS on how provisions are recognized and measured would be beneficial
- IPSAS does not currently incorporate IFRIC 21 – In practice are public sector entities following that guidance through the GAAP hierarchy?
- IPSAS doesn't contain IFRIC 6 as the IPSASB previously determined has limited applicability in public sector

QUESTIONS?

