

## IASB<sup>®</sup> meeting

Date	<b>April 2024</b>
Project	<b>Provisions—Targeted Improvements</b>
Topic	<b>Threshold-triggered costs</b>
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## Session overview

1. IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* specifies three criteria for recognising a provision. The first of these criteria is that the entity has a present obligation as a result of a past event (present obligation recognition criterion). Agenda Paper 22A *Present obligation recognition criterion* for this meeting sets out staff recommendations for amendments to the general requirements supporting that criterion. It includes proposals to clarify when an obligation becomes a *present* obligation.
2. In this session, we will ask the International Accounting Standards Board (IASB) to decide:
  - (a) whether to propose to add application requirements for costs payable if a measure of the entity's activity in a period exceeds a specified threshold (threshold-triggered costs)—to clarify when an obligation for such costs becomes a present obligation; and
  - (b) if so, what requirements to propose.

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3. We recommend proposing to add application requirements for threshold-triggered costs, and proposing requirements that (reflecting View 3 described later in this paper):
- (a) a present obligation for a threshold-triggered cost arises as the entity performs the activity that contributes to the total amount on which the cost is measured; and
  - (b) at any date within the measurement period, the amount of the present obligation is a portion of the total estimated cost for the measurement period, the portion being the amount attributable to the activity performed to date.

### Threshold-triggered costs

4. Examples of threshold-triggered costs within the scope of IAS 37 are:
- (a) levies targeted on larger entities operating within a market—for example, levies payable by entities whose annual revenue exceeds a specified monetary amount;
  - (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 specified measurement period exceed a quota allocated to that entity; and
  - (c) maintenance costs a lessee incurs if the condition of a leased asset at the end of the lease is lower than a specified threshold—for example, if the remaining time a leased aircraft will be able to fly before its next overhaul is lower than a specified number of hours.<sup>1</sup>

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<sup>1</sup> Paragraph 24(d) in IFRS 16 *Leases* requires a lessee to include in the measure of a right-of-use asset an estimate of the costs to be incurred in restoring the underlying asset to the condition required by the terms and conditions of the lease. It notes that the lessee might incur the obligation for these costs either at the lease commencement date or as it uses underlying asset during a particular period. Paragraph 25 in IFRS 16 clarifies that the obligations for the costs

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## Staff analysis—whether to propose application requirements for threshold-triggered costs

5. In this section we consider possible arguments for and against proposing application requirements for threshold-triggered costs.

### *Possible arguments for proposing application requirements*

6. Questions arise in practice about the timing of recognition of threshold-triggered costs—that is, when an obligation to pay such costs becomes a present obligation. Is it:
- (a) as the entity starts to perform the activity that contributes to the total being measured (perhaps depending on the circumstances); or
  - (b) only when the entity’s activity exceeds the threshold?
7. Applying either view, the accounting treatment may be the same if the measurement period coincides with an entity’s financial reporting period—for example, when both are calendar years. However, differences arise if the two periods do not coincide, for example:
- (a) if an annual measurement period ends after an annual financial reporting period;
  - (b) if financial statements are prepared for an interim financial reporting period; or
  - (c) if the measurement period for a threshold-triggered cost is longer than one year—as could be the case for some penalties for excess greenhouse gas emissions, for example, if the penalty is measured by averaging the entity’s emissions over several years.

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are recognised and measured applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. (The obligation is recognised as a provision—it is not included in the measure of the lease liability.)

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8. IFRIC 21 *Levies*, an interpretation of IAS 37, specifies requirements for threshold-triggered levies. The consensus in IFRIC 21 is that the ‘obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation’. Illustrative Example 4 accompanying IFRIC 21 applies this consensus to a levy an entity is required to pay on revenue in excess of 50 million currency units (CU) in a calendar year. The example concludes that a present obligation starts to arise only when the entity’s revenue in the calendar year exceeds the CU50 million threshold—the entity accrues a liability over the rest of that year as it generates revenue above the threshold.
  9. The conclusion in this illustrative example applies directly only to levies within the scope of IFRIC 21. We have received questions about whether, and if so in what circumstances, preparers of financial statements should apply the conclusion by analogy to other threshold-triggered costs within the scope of IAS 37. Some stakeholders think the conclusion does not result in useful information—they argue that if no provision is recognised until a threshold has been exceeded, the financial statements before that date misrepresent (flatter) the entity’s financial performance and financial position. Stakeholders note that the effects are most pronounced for threshold-triggered costs with long (multiple-year) measurement periods—entities whose activity level remains constant throughout the measurement period might recognise no costs in some years and large costs in other years.
  10. As discussed in Agenda Paper 22A for this meeting, the IASB is developing proposals to amend the requirements supporting the present obligation recognition criterion in IAS 37. The proposed new requirements would apply concepts added to the *Conceptual Framework for Financial Reporting (Conceptual Framework)* in 2018.

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11. IFRIC 21 is inconsistent with these concepts. Accordingly, in Agenda Paper 22A, the staff recommend that the proposed amendments to IAS 37 include a proposal to withdraw IFRIC 21. If the illustrative examples accompanying IFRIC 21 are to be retained (by being added to the illustrative examples accompanying IAS 37), their conclusions would need to be updated to be consistent with the new requirements.
  12. We think that it is not clear how an entity would apply the new requirements to threshold-triggered costs—the requirements could be interpreted in various ways. So adding application requirements for threshold-triggered costs to IAS 37 could:
    - (a) reduce costs (time and effort) for preparers of financial statements;
    - (b) promote consistent application; and
    - (c) provide a basis for an updated conclusion for the threshold-triggered levy example (Illustrative Example 4) accompanying IFRIC 21, if the IASB decides to add that example to those accompanying IAS 37.
  13. Between June 2023 and November 2023 we consulted various groups of stakeholders for their views on initial staff suggestions for possible amendments to IAS 37. The groups we consulted included:
    - (a) users of financial statements—via the IASB’s Capital Markets Advisory Committee and other informal groups;
    - (b) preparers of financial statements—via the IASB’s Global Preparers Forum and other informal groups;
    - (c) national standard-setters—via the IASB’s Accounting Standards Advisory Forum; and
    - (d) the IFRS Interpretations Committee.

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14. Among the matters we discussed with these groups was whether the IASB should add to IAS 37 application requirements for threshold-triggered costs. All group members who expressed a view on this matter said they thought such application requirements would be helpful. Comments included views that:
- (a) threshold-triggered costs are becoming relatively common features of climate-related regulations;
  - (b) threshold-triggered costs of various types are particularly common in some sectors—for example in the pharmaceutical and oil & gas sectors;
  - (c) application requirements would be especially useful for interim financial statements; and
  - (d) application guidance would help highlight the difference between the amended requirements and those in IFRIC 21.

***Possible arguments against proposing application requirements***

15. A possible argument against proposing application requirements for threshold-triggered costs is that any such requirements could prematurely change the timing of recognition of liabilities arising from some pollutant pricing mechanisms.
16. Some pollutant pricing mechanisms include threshold-triggered costs that are within the scope of IAS 37. The terms and conditions vary and can be complex, and it could be argued that further research is required before the IASB proposes any new requirements that could affect the way an entity accounts for these costs.

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17. The IASB has a project on pollutant pricing mechanisms on its ‘reserve list’—a list of projects it will add to the work plan if additional capacity becomes available before its next five-yearly agenda consultation. Since the IASB created that reserve list, several stakeholders have suggested a need to prioritise a project on pollutant pricing mechanisms, due to the increasing prevalence of these mechanisms and deficiencies in accounting for them. The staff are now gathering information about accounting matters involving pollutant pricing mechanisms and their prevalence. If the IASB adds a project on pollutant pricing mechanisms to its work plan:
- (a) its decisions in that project could be constrained by application requirements for threshold-triggered costs in IAS 37; or
  - (b) entities with threshold-triggered costs arising from pollutant pricing mechanisms could face two changes in practice in quick succession if the pollutant pricing mechanisms project results in requirements that are inconsistent with those added to IAS 37.

### **Staff analysis—what requirements to propose**

18. In this section, we consider what requirements the IASB might propose if it decides to propose application requirements for threshold-triggered costs.
19. We have identified three factors for the IASB to consider:
- (a) the general requirements on which the application requirements would be based (paragraphs 20–28);
  - (b) stakeholder views (paragraphs 29–32);
  - (c) consistency with requirements in other IFRS Accounting Standards (paragraphs 33–45).

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***The general requirements on which application requirements would be based****Applicable requirements*

20. Applying paragraph 14 of IAS 37 (with the wording amendments recommended in Agenda Paper 22A), an entity would recognise a provision if three criteria are met:
  - (a) the entity has a present obligation to transfer an economic resource as a result of a past event (present obligation recognition criterion);
  - (b) it is probable that the entity will be required to transfer an economic resource to settle the obligation (probable transfer recognition criterion); and
  - (c) a reliable estimate can be made of the amount of the obligation (reliable estimate recognition criterion).
21. Table 6 in the appendix to Agenda Paper 22A explains how requirements supporting the present obligation recognition criterion could be developed on the basis of concepts added to the *Conceptual Framework* in 2018, and Agenda Paper 22E *Indicative drafting*—IAS 37 includes drafting suggestions for the general requirements.
22. The requirements that would apply to threshold-triggered costs are drafted in paragraphs 19A–19C in Agenda Paper 22E:



**Extract from Agenda Paper 22E *Indicative drafting—IAS 37***

- 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.
- 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.
- 19C In some situations, an entity will be required 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).

***Application to threshold-triggered costs***

23. To apply these general requirements to threshold-triggered costs, we need to identify the ‘action’ (paragraph 19A) or ‘actions’ (paragraph 19C), as a consequence of which the entity ‘will or may have to transfer an economic resource it would not otherwise have had to transfer’.
24. We have heard three views on what that action, or those actions, would be:

View	‘Action’ creating present obligation	Rationale	Accounting consequences
1	One action—activity <i>above</i> the threshold.	Activity above the threshold is the only action whose consequence is a requirement to transfer an economic resource.	<p>Applying paragraph 19A, an entity recognises a provision only after its activity exceeds the threshold:</p> <ul style="list-style-type: none"> <li>• assuming the other recognition criteria (probable transfer and reliable estimate) are met by that time.</li> </ul>
2	<p>Two actions:</p> <ol style="list-style-type: none"> <li>1. activity <i>below</i> the threshold, and</li> <li>2. activity <i>above</i> the threshold.</li> </ol>	Activity below the threshold is a necessary action because without it there can be no activity above the threshold.	<p>Applying paragraph 19C, an entity recognises a provision as it performs activity below the threshold:</p> <ul style="list-style-type: none"> <li>• if it will have no practical ability to avoid activity above the threshold; and</li> <li>• if the other recognition criteria (probable transfer and reliable estimate) are met.</li> </ul>
3	One action—any activity contributing to the total on which the cost is measured.	Irrespective of whether the measure of the entity’s activity is below or above the threshold, there is only one activity (eg generating revenue or emitting gases). All of that activity affects the cost the entity may incur. An entity whose activity takes it closer to the threshold may incur a cost that that it would not otherwise have incurred (without that activity).	<p>Applying paragraph 19A, an entity recognises a provision as it performs any activity that contributes to the total amount on which the cost is measured:</p> <ul style="list-style-type: none"> <li>• if the other recognition criteria (probable transfer and reliable estimate) are met.</li> </ul>

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25. Applying any of these three views, the action is an activity that might take place over time. Accordingly, applying paragraph 19B of the amended requirements, the present obligation might accumulate over time.
  26. Requirements based on View 2 and View 3 might have similar outcomes in practice due to the effect of the probable transfer recognition criterion. If management concludes that an entity has no practical ability to avoid its activity exceeding the threshold, it might also be likely to conclude that it is probable that a cost will be incurred. And if management concludes that the entity has the practical ability to avoid its activity exceeding the threshold, it might also conclude that it is probable that no cost will be incurred. However, the judgements required to conclude on an entity's *practical ability* to exceed a threshold are not identical to the those required to conclude on the *probability* of it exceeding the threshold, meaning that View 2 might be more complex to apply in practice, and stakeholders might call for additional guidance.
  27. Applying either View 2 or View 3 (but not View 1), the amount of the present obligation would have to be estimated by forecasting the total activity for the measurement period and the total cost payable on that activity. At any date within the measurement period, the amount of the present obligation would be estimated. It would be a portion of that total estimated cost for the measurement period, the portion being the amount attributable to the activity performed to date.
  28. The implications of the three views are illustrated in the appendix to this paper using the fact patterns in Illustrative Example 4 accompanying IFRIC 21.

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**Stakeholder views**

29. When we asked groups of stakeholders for their views on *whether* to add to IAS 37 application requirements for threshold-triggered costs, we also asked them for views on *what* the requirements should be.
30. We heard similar views from all the groups we consulted—preparers, users of financial statements and auditors of financial statements. Most stakeholders who expressed views said they thought that an entity should start to recognise a provision as its activity progresses towards the threshold, at least in some circumstances—for example, if management expects the entity’s activity to exceed the threshold, or if the entity has no practical ability to avoid exceeding the threshold. Among their reasons were views that:
- (a) such a requirement would be more consistent with the accrual basis of accounting and would reduce volatility in the income statement.
  - (b) a liability starts to arise when an entity starts to undertake the activity on which the cost is measured. Every unit of activity is a driver of the liability. Activity below the threshold is no different from activity above the threshold. An entity cannot simply turn off its activity to avoid a charge.
  - (c) accruing a provision based on the expected amount attributable to each unit of activity would provide more useful information to investors.
  - (d) recognising a provision only after the threshold has been met could provide misleading information to investors. It does not faithfully represent the entity’s financial performance and financial position in the (interim) period before the threshold is met.
  - (e) the facts are analogous to those in which income taxes or employee bonuses are payable only on earnings or profits above a target or threshold. IAS 12 *Income Taxes* and IAS 19 *Employee Benefits* require liabilities to be

recognised by estimating and apportioning the total amounts that will be payable for the period.

- (f) management always has approved budgets and forecasts that it can use to prepare estimates of activity for the measurement period, and auditors can use to verify the estimates.

31. In some groups, a minority of group members said they thought that provisions should be recognised only when the entity's activity has exceeded the threshold. Among their reasons were views 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 measurement period.
- (b) the resulting estimates could be highly subjective and susceptible to error—especially if there is a lack of historical information on which to base estimates, or a history of poor management judgement. In some cases, an entity might recognise a provision in one period and reverse it in a later period when expectations change.
- (c) a requirement to recognise a provision only after the entity's activity exceeds the threshold would be clear and easy to apply.

32. Other comments included:

- (a) a concern about any approach that would require management to assess the entity's practical ability to avoid exceeding a threshold (ie an approach based on View 2 described in the table below paragraph 24. An auditor suggested that such a requirement could be difficult to interpret and hence susceptible to inconsistent application without extensive guidance.

- (b) a suggestion that the IASB consider whether questions about provisions for threshold-triggered costs are recognition or measurement questions.
- (c) an observation that in borderline cases—for example, where management estimates that the entity’s revenue could get close to, but not exceed, the threshold (such that the probable transfer recognition criterion would not be met)—it would be important to disclose material information about the entity’s contingent liability.

### ***Consistency with requirements in other IFRS Accounting Standards***

33. Several other IFRS Accounting Standards address the recognition of liabilities for costs an entity will pay only if a measure of its activity exceeds a specified threshold. These costs include some:
- (a) variable lease payments (paragraphs 34–38);
  - (b) employee benefits and share-based payments subject to vesting conditions (paragraphs 39–42); and
  - (c) graduated-rate income taxes (paragraphs 43–45).

#### ***Variable lease payments***

34. A lease agreement might require a lessee to make threshold-triggered lease payments, if a measure of the lessee’s activity—for example, its revenue from a leased retail unit—exceeds a specified threshold.
35. IFRS 16 *Leases* does not specifically refer to threshold-triggered lease payments. However, it has general requirements for recognition of variable lease payments (of any type). It requires the lessee to exclude variable lease payments (other than those that depend on an index or rate) from the initial measure of the lease liability, and recognise them only when the event or condition that triggers the payment occurs.

We think this requirement could be read as prohibiting a lessee from recognising a threshold-triggered lease payment before its activity exceeds the threshold.

36. For some of the IASB members approving IFRS 16, the requirements relating to variable lease payments reflected cost-benefit considerations, not a view that a present obligation arises only on the occurrence of triggering event or condition. As paragraph BC169 in the Basis for Conclusions accompanying IFRS 16 explains:

BC169 ... For some Board members, this decision was made solely for cost-benefit reasons. Those Board members were of the view that all variable lease payments meet the definition of a liability for the lessee. However, they were persuaded by the feedback received from stakeholders that the costs of including variable lease payments linked to future performance or use would outweigh the benefits, particularly because of the concerns expressed about the high level of measurement uncertainty that would result from including them and the high volume of leases held by some lessees. ...

37. IAS 34 *Interim Financial Reporting* requires a different approach for threshold-triggered lease payments in interim financial statements. Paragraph B7 in the Implementation Guidance accompanying IAS 34 specifically addresses a situation in which an entity would recognise a liability for a threshold-triggered lease payment before it reaches the threshold:

B7 Variable lease payments based on sales can be an example of a legal or constructive obligation that is recognised as a liability. If a lease provides for variable payments based on the lessee achieving a certain level of annual sales, an obligation can arise in the interim periods of the financial year before the required annual level of sales has been achieved, if that required level of sales is expected to be achieved and the entity, therefore, has no realistic alternative but to make the future lease payment.

38. In considering whether and how to align IAS 37 requirements for threshold-triggered costs with those in IFRS 16 or IAS 34, it is of note that cost-benefit considerations might carry less weight for provisions than for lease liabilities:

- (a) the measurement period for a threshold-triggered cost within the scope IAS 37 likely to be shorter than a typical lease term, so forecasts of future activity levels are unlikely to be subject to such high measurement uncertainty; and
- (b) the probable transfer and reliable estimate recognition criteria would prevent entities from recognising provisions where the costs of recognition were most likely to outweigh the benefits.

*Employee benefits and share-based payments subject to vesting conditions*

39. IAS 19 *Employee Benefits* requires an entity to recognise a liability for all employee benefits expected to be paid in exchange for past service—including benefits that are conditional on the entity continuing to employ the employee for a specified period (the vesting period).<sup>2</sup> Paragraph BC55 of the Basis for Conclusions accompanying IAS 19 explains that:

BC55 IASC believed that an obligation exists even if a benefit is not vested, in other words if the employee's right to receive the benefit is conditional on future employment. For example, consider an entity that provides a benefit of CU100 to employees who remain in service for two years. At the end of the first year, the employee and the entity are not in the same position as at the beginning of the first year, because the employee will need to work for only one more year, instead of two, before becoming entitled to the benefit. Although there is a possibility that the benefit may not vest, that difference is an obligation and, in IASC's view, should result in the recognition of a liability at the end of the first year. The measurement of that obligation at its present value reflects the entity's best estimate of the probability that the benefit may not vest.

40. The requirements in IFRS 2 *Share-based Payment* for cash-settled share-based payments are consistent with those in IAS 19. An entity recognises a liability for such payments when it receives the goods or services to which they relate even if at that

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<sup>2</sup> Paragraphs 20 (profit-sharing and bonus plans) and 72 (post-employment defined benefit plans) in IAS 19 *Employee Benefits*.



time the payments are subject to vesting conditions. Vesting conditions could include measures of the entity's own future performance, and might require that performance to exceed a specified threshold.

41. Paragraphs BC243–BC245 in the Basis for Conclusions accompanying IFRS 2 explain why the IASB concluded that a liability exists before the vesting date. These paragraphs refer to the rationale in the Basis for Conclusions accompanying IAS 19 (see paragraph 39) and note the Board's conclusion that the requirements in IFRS 2 should be consistent with those in IAS 19.
42. We think requirements in IAS 37 for threshold-triggered costs would be most consistent with those in IAS 19 and IFRS 2 if they were based on View 3.

#### *Graduated-rate income taxes*

43. An entity might pay income tax at graduated rates—that is, at one rate on annual taxable profits below a specified threshold and at another rate on annual taxable profits above that threshold. The rate on taxable profits below the threshold might be 0 per cent. If so, the facts are analogous to those described in the basic fact pattern in Illustrative Example 4 accompanying IFRIC 21 (see paragraph 8).
44. Paragraphs B12–B16 in the Illustrative Examples accompanying IAS 34 explain how an entity subject to graduated-rate income taxes would measure its current tax liability in interim financial statements. They require the entity to estimate and apply the average rate that would apply to the entity's expected total annual earnings (not the average rate that will apply to the taxable profits earned by the end of the interim period).
45. We think requirements in IAS 37 for threshold-triggered costs would be most consistent with those for graduated tax rates in IAS 34 if they were based on View 3.

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## Staff conclusions

### ***Conclusion on whether to propose application requirements for threshold-triggered costs***

46. We think that the IASB should propose to add to IAS 37 application requirements for threshold-triggered costs:
- (a) evidence we have gathered from stakeholders indicates that threshold-triggered costs within the scope of IAS 37 are widespread, and could become more widespread as governments extend the range of climate-related obligations they impose on entities operating within their jurisdictions.
  - (b) we think the general requirements that the IASB is proposing to add to IAS 37 could be interpreted in at least three different ways (as described in the table below paragraph 24) and so adding application requirements could reduce costs (time and effort) for preparers of financial statements and promote consistent application of IAS 37.
47. While we acknowledge there could be potential problems arising from prematurely changing requirements for costs arising from pollutant pricing mechanisms (as discussed in paragraphs 15–17), we have not yet identified specific problems—stakeholders we consulted raised no specific issues. The most effective way of identifying potential problems could be to include proposals for threshold-triggered costs in the Exposure Draft of proposed amendments to IAS 37 and consider the feedback we receive.

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**Conclusion on what requirements to propose**

48. If the IASB decides to propose application requirements for threshold-triggered costs, we think it should propose requirements based the View 3 described in the table below paragraph 24—that is, a present obligation arises as the entity performs the activity that will contribute to the total amount on which the cost is measured. We think that:
- (a) conceptually, the entity conducts only that one activity (not two separate activities) and all of that activity affects the resources the entity will or may have to transfer—an entity whose activity takes it closer to the threshold may incur a cost that that it would not otherwise have incurred (without that activity).
  - (b) stakeholders view a requirement to recognise a provision as an entity’s activity progresses towards the threshold as resulting in more useful information than a requirement to recognise a provision only after the activity exceeds the threshold.
  - (c) the other recognition criteria in IAS 37—the probable transfer and reliable estimate criteria—are such that an entity would recognise a provision only when management expects its activity over the measurement period to exceed the threshold. We could use an illustrative example to make this point clear.
  - (d) the requirements in IAS 37 would be consistent with requirements for threshold-triggered costs in IFRS 2, IAS 12, IAS 19 and IAS 34.
49. We have included indicative drafting of application requirements for threshold-triggered costs in paragraph 19D of Agenda Paper 22E.

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## Staff recommendations and questions for the IASB

50. For the reasons in paragraphs 46–47, the staff recommend proposing to add to IAS 37 application requirements for threshold-triggered costs—to clarify when an obligation for such costs becomes a present obligation.
51. For the reasons in paragraph 48, the staff recommend proposing that:
- (a) a present obligation for a threshold-triggered cost arises as the entity performs the activity that contributes to the total amount on which the cost is measured; and
  - (b) at any date within the measurement period, the amount of the present obligation is a portion of the total estimated cost for the measurement period, the portion being the amount attributable to the activity performed to date.

### Questions for the IASB

1. Do you agree with the recommendation in paragraph 50, to propose adding to IAS 37 application requirements for threshold-triggered costs?
2. Do you agree with the recommendation to propose the requirements set out in paragraph 51?

## Appendix—Example to illustrate the implications for the three views described in this paper

### *Illustrative Example*

- A1. We illustrate below the implications of the three views described in the paragraphs 24–27 this paper, using the fact patterns in Illustrative Example 4 accompanying IFRIC 21:

#### **Fact patterns in Illustrative Example 4 accompanying IFRIC 21**

**(a) Basic fact pattern**

An entity is required to pay a levy if it generates revenue in excess of CU50 million in a calendar year. The levy is 2 per cent of the entity's revenue in excess of CU50 million.

The entity has an annual reporting period that ends on 31 December. Its revenue exceeds the CU50 million threshold on 17 July.

**(b) Varied fact pattern**

The fact pattern is as above (the entity pays a levy only if it generates revenue in excess of CU50 million in the calendar year) except that the amount of the levy is calculated by reference to the *total* revenue generated in the year, including the first CU50 million.

#### **Additional facts needed to apply View 2 and View 3**

Management forecasts that the entity's revenue for the year will be CU100 million, and hence that the levy for the year will be:

- (a) CU1 million in the basic fact pattern (CU50 million x 2 per cent); and
- (b) CU2 million in the varied fact pattern (CU100 million x 2 per cent).

*View 1—a present obligation arises only when the entity exceeds the threshold*

- A2. Applying View 1, a present obligation arises only when the entity generates revenue in excess of the threshold:
- (a) in both the basic and varied fact patterns, there is no present obligation until 17 July;
  - (b) in the basic fact pattern, a present obligation accumulates gradually between 17 December and 31 December at a rate of 2 per cent of the revenue generated in that period.
  - (c) in the varied fact pattern, a present obligation:
    - (i) first arises on 17 July—for the CU1 million levy attributable to the CU50 million revenue generated by that date; and
    - (ii) increases gradually between then and 31 December at a rate of 2 per cent of the revenue generated in that period.
- A3. Applying View 1:
- (a) the entity recognises no liability in interim financial statements (if any) it prepares for the first or second quarters of the year. In the varied fact pattern, there is a ‘cliff-edge’ effect, whereby the whole of the levy attributable to the revenue generated before 17 July is recognised on 17 July.
  - (b) the amount of the present obligation is known by the time it arises—there is no measurement uncertainty in the measure of the liability.

*View 2—a present obligation starts to arise when the entity starts to perform the activity if it has no practical ability to avoid exceeding the threshold*

- A4. Applying view 2, a present obligation arises as soon as the entity starts generating revenue if management judges the entity has no practical ability to avoid exceeding the threshold and the probable transfer and reliable estimate recognition criteria are met. The amount of the obligation accumulates as the entity generates revenue—at any date within the year (for example, at the end of the first or second quarters) it is the portion of the levy forecast to be payable for the whole year attributable to the revenue generated at that date. For example, by 17 July, when the entity has generated half of its forecast annual revenue (half of CU100 million), it will recognise a provision for half of the forecast annual levy—that is, CU0.5 million in the basic fact pattern, or CU1 millions in the varied fact pattern.
- A5. Applying View 2:
- (a) judgement is required in determining whether the entity has the practical ability to avoid exceeding the threshold and whether it is probable that a levy will be paid. The amount of judgement required might reduce as the year progresses.
  - (b) the amount of the obligation is not known when the present obligation starts to arise—it requires a forecast of total revenue for the measurement period—so is subject to measurement uncertainty. The measurement uncertainty will be highest at the start of the year and reduce to zero by the end of the year.
  - (c) the levy is recognised smoothly as revenue is generated through the year if from the start of the year management judges the entity has no practical ability to avoid exceeding the threshold, it is probable that a levy will be paid and a reliable estimate can be made of the amount of the obligation.

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*View 3—a present obligation arises as the entity performs activity that will contribute to the total on which the cost is measured*

- A6. The third view is that a present obligation arises as the entity generates revenue that will contribute to the total revenue on which the levy is measured. The amount of the obligation accumulates as the entity generates revenue—at any date within the year it is the portion of the levy forecast to be payable for the whole year attributable to the revenue generated at that date. For example, by 17 July, when the entity has generated half of its forecast annual revenue (half of CU100 million), it will recognise a provision for half of the forecast annual levy—that is, CU0.5 million in the basic fact pattern, or CU1 millions in the varied fact pattern.
- A7. Applying View 3:
- (a) the amount of the obligation is not known when the present obligation starts to arise—it requires a forecast of total revenue for the period—so is subject to measurement uncertainty. The measurement uncertainty will be highest at the start of the year and reduce to zero by the end of the year.
  - (b) the levy is recognised smoothly as revenue is generated through the year if the other recognition criteria in IAS 37 are met—that is, if from the start of the year management judges it probable that the entity will have to pay a levy and can make a reliable estimate of the amount of the obligation.