IFRS® Accounting

Staff paper

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Project	**Provisions—Targeted Improvements**
Topic	**Transition requirements**
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Purpose of this session

1. In this project, the International Accounting Standards Board (IASB) is developing proposals for three targeted amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. It has reached tentative decisions on all three topics. These tentative decisions are set out in the appendix to Agenda Paper 22 *Cover note and summary of previous tentative decisions*.

2. In this session, the IASB will be asked to consider the need for:

   (a) transition requirements for entities transitioning from the existing version of IAS 37 to the amended one; and

   (b) amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* for entities applying IFRS Accounting Standards for the first time (first-time adopters) and applying the amended version of IAS 37 instead of the existing one.

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Specific transition requirements in IAS 37

3. In this section we discuss whether to propose specific transition requirements for entities that already apply IFRS Accounting Standards and change an accounting policy on initial application of the amended version of IAS 37.

General requirements for applying changes in accounting policies

4. Paragraph 19 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires an entity to account for a change in an accounting policy resulting from the initial application of an IFRS Accounting Standard:

    (a) in accordance with the specific transition requirements set out in that Standard, if any; or

    (b) retrospectively (as if the policy had always been applied) if there are no specific transition requirements in the Standard.

5. The IAS 8 requirement for retrospective application is subject to limitations. An entity is required to apply a change in accounting policy retrospectively only as far back as is practicable, if it is impracticable to determine either:

    (a) the period-specific effects of changing the policy on comparative information for one or more prior periods presented, or

    (b) the cumulative effects on the amounts at the beginning of the current period of applying the new policy to all prior periods.

Reasons for including specific transition requirements in a new or amended IFRS Accounting Standard

6. In most cases, retrospective application of a change in accounting policy results in more useful information for investors than alternative forms of application (for example, prospective application or some form of modified retrospective application. With prospective application, an entity applies the new policy only to transactions occurring after the date of the policy change. With retrospective application, an entity presents its financial statements as if the new policy had always been effective, which can enhance:
   (a) faithful representation—the financial performance reported for the current period is not distorted by effects attributable to previous periods;
   (b) comparability—the information the financial statements provide for the current period is comparable with the information they provide for comparative periods; and
   (c) understandability—the adjustments made to the comparative amounts reported in previous periods might be easier to explain and understand than adjustments that would be made applying a modified retrospective method.

7. However, in some cases, retrospective application of a change in accounting policy might be impracticable, or the costs of retrospective application might exceed the benefits. In these cases, a new or amended IFRS Accounting Standard can specify alternative transition requirements.

8. We consider in this section whether alternative transition requirements might be appropriate for the amendments proposed in this project:
   (a) the proposed amendments to the requirements supporting the present obligation recognition criterion (paragraphs 10–12);

(b) the proposal to specify the discount rate an entity uses in measuring a provision (paragraphs 13–23);

(c) the proposal to specify the costs to include in the measure of a provision (paragraphs 24–32); and

(d) the consequential amendment to IFRS 3 *Business Combinations* discussed in Agenda Paper 22A *Sweep Issues* for this meeting (paragraphs 33–39).

9. A staff recommendation covering all four of these amendments is set out in paragraphs 40–42.

Proposed amendments to requirements supporting the present obligation recognition criterion

Changes in accounting policy that might be required

10. The amendments proposed to the requirements supporting the present obligation recognition criterion would require earlier recognition of some provisions, most notably some provisions for:

(a) costs (typically levies) that become payable only when an entity has taken two or more actions[1]; or

(b) costs (including levies, climate-related penalties or variable lease payments) that become payable only when a measure of the entity's activity exceeds a specified threshold.[2]

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1 See Table 6 in the appendix to IASB April 2024 meeting Agenda Paper 22A *Provisions—Targeted Improvements—Present obligation recognition criterion*.

2 See IASB April 2024 meeting Agenda Paper 22B *Provisions—Targeted Improvements—Threshold-triggered costs*.

Staff analysis and conclusions

11. We think that retrospective application of those amendments is likely to be practicable for most entities, and that the benefits of retrospective application are likely to exceed the costs. This view reflects our understanding that:
    (a) the types of costs for which a change in accounting policy is most likely to be required (levies and similar costs) are typically recurring charges—often recurring annually. With prospective application, an entity might recognise two annual charges as expenses the period of initial application of the amended requirements, and no charges as expenses in the comparative period. The income statements for the current and comparative periods would not be comparable and would not provide a faithful representation of the entity's financial performance in either period.
    (b) the types of costs for which a change in accounting policy would be required are typically recognised as expenses when the provision is recognised, or included in the cost of inventory—they are typically not added to the costs of property, plant and equipment or other long-term assets. So retrospective application would not require an entity to gather information about transactions occurring long before the start of the comparative period.

12. Accordingly we conclude that no specific transition requirements should be proposed for the amendments to the requirements supporting the present obligation recognition criterion. This conclusion is reflected in our overall recommendation in paragraphs 40–42.

Proposal to specify the discount rate an entity uses in measuring a provision

Changes in accounting policy that might be required

13. IAS 37 requires an entity to measure a provision at the best estimate of the expenditure (cash outflows) required to settle the present obligation, with those cash outflows discounted to their present value if the time value of money is material. The types of provisions most likely to be discounted are large long-term provisions—typically provisions for asset decommissioning and environmental rehabilitation costs recognised by entities operating in the oil & gas, mining, energy and telecommunications sectors.

14. The IASB has tentatively decided to propose specifying a discount rate that reflects current market assessments of the time value of money—as represented by a risk-free rate—with no adjustment for non-performance risk.

15. At present, some entities discount asset decommissioning and environmental rehabilitation provisions at rates that reflect some degree of non-performance risk. Such entities would need to change their accounting policy to use a lower rate than they have used in previous periods.

16. The change in accounting policy would result in those entities recognising a larger provision. In some cases, the entity would recognise the corresponding debit as an expense. But in many cases, they would recognise it as an addition to the cost of the property, plant or equipment (PPE) to which the decommissioning or rehabilitation obligation relates.

Staff analysis and conclusions

17. Where the cost of fulfilling an asset decommissioning or environmental rehabilitation obligation is added to the cost of the related PPE, applying a change in the basis for

determining the discount rate fully retrospectively could be difficult. It would require the entity to gather or reconstruct information generated from the time of initial recognition of the provision—which could be decades in the past if the provision relates to the decommissioning of long-lived assets.

18. A particular complication arises because IAS 37 requires an entity to measure a provision using *current* estimates of the cash outflows required to settle the provision and a *current* market assessment of the time value of money:

    (a) the measure of an asset decommissioning or environmental rehabilitation provision can therefore fluctuate from one reporting date to the next because of changes in estimates of the cash outflows or of current market interest rates; and

    (b) IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* requires such changes to be added to, or deducted from, the cost of the related PPE—and recognised in the income statement prospectively as that PPE is depreciated over its useful life or when it is judged to be impaired. Consequently, the amount of decommissioning costs recognised in the carrying amount of PPE at the date of transition would depend on when and how estimates of the future cash outflows and market interest rates had fluctuated from the date the decommissioning obligation arose.

19. This means that pure retrospective application of a change in the basis for determining the discount rate for the provision would require an entity to construct a historical record of all the adjustments that would have been made to PPE at each reporting date between initial recognition of the provision and the date of transition—applying the new-basis discount rate current at each reporting date to the estimates of the cash outflows current at that date. The entity would need to determine the historical discount rates from historical records of market interest rates. And if it had not kept a record of its estimates of the cash outflows and amounts of impairment losses recognised, from the date of initial recognition of the provision, it would need to

reconstruct those estimates and amounts on the basis of the information it would have had at the time (that is, without the use of hindsight).

20. The IASB has previously concluded that constructing such a historical record would be impracticable for first-time adopters of IFRS Accounting Standards.[3] Accordingly IFRS 1 exempts first-time adopters from applying IFRIC 1 for fluctuations in estimates of the cash outflows and market interest rates that occurred before the date of transition to IFRS Accounting Standards.

21. IFRS 1 requires an entity that elects to use this exemption to apply a simplified retrospective approach, whereby the entity:

    (a) applies IAS 37 to measure the liability at the date of transition:

    (b) estimates the amount that would have been included in the cost of PPE when the liability first arose, by discounting the liability to that date using the entity's best estimate of the historical discount rate(s) that would have applied for that liability over the intervening period; and

    (c) calculates the accumulated depreciation on that amount, as at the date of transition, on the basis of the current estimate of the useful life of the PPE.

22. We think a similar election would be justified for an entity that changes the basis of determining its discount rates on transitioning from the existing to the amended version of IAS 37. We think that, in many cases, full retrospective application would be impracticable. And even where practicable, the costs might exceed the benefits because much of the effect of previous adjustments to the cost of the PPE might have reversed by the transition date due to depreciation in the intervening period.

[3] Paragraph BC63C of the Basis for Conclusions accompanying IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

23. As reflected in our overall recommendation in paragraphs 40–42, we think that an entity changing its accounting policy as a result of the amendments to the discount rate requirements should be permitted to apply a simplified retrospective approach whereby, in the year of transition the entity:

    (a) restates the provision at the start of the first period for which it presents comparative information, applying the amended IAS 37 requirements;

    (b) apportions the amount by which it adjusts the provision at that date between the related PPE and retained earnings:

        (i) estimating the amount it would have included in the cost of the PPE when the provision was first recognised assuming the current discount rate(s) and estimates of cash flows used in measuring the provision have not changed since the provision was first recognised; and

        (ii) estimating the accumulated depreciation on that amount using current estimates of the useful life of the PPE.

Proposal to specify the costs to include in the measure of a provision

Changes in accounting policy that might be required

24. IAS 37 applies to onerous executory contracts, including contracts within the scope of IFRS 15 *Revenue from Contracts with Customers* that have become onerous. In 2020, the IASB amended IAS 37 to clarify that the costs an entity includes in determining whether a contract is onerous (that is whether a provision should be *recognised*) include:

    (a) the incremental costs of fulfilling the contract; and

    (b) an allocation of other costs that relate directly to fulfilling contracts.

25. The amendments now proposed in this project would clarify that an entity includes these same types of costs in *measuring* any onerous contract provision recognised—and in measuring the expenditure required to settle any other type of provision within the scope of IAS 37.

26. An entity would be required to change its accounting policy if, applying IAS 37 at present, it includes in the measure of an obligation to provide goods or services only the incremental costs of settling that obligation.

27. We think that relatively few entities would be required to change their accounting policy as a result of this amendment:

    (a) with the exception of onerous contracts with customers, relatively few obligations within the scope of IAS 37 are obligations an entity settles by providing goods or services itself, incurring significant overheads beyond the incremental costs of fulfilment. Entities with asset decommissioning and environmental rehabilitation obligations often subcontract fulfilment of these obligations, with virtually all costs being incremental costs.

    (b) we understand that many entities with onerous contracts already use the same costs to measure an onerous contract provision as they use to determine that the contract is onerous. Guidance issued by some of the large accounting firms refers to previous IASB and IASB staff observations that 'preparers of financial statements might reasonably decide that the same costs [as those used to determine whether a contract is onerous] should also be used to measure any onerous contract provision recognised, and perhaps to measure all other types of provisions for obligations to provide goods or services'.[4]

[4] Paragraph BC14 of Exposure Draft ED/2018/2 *Onerous Contracts-Cost of Fulfilling a Contract: Proposed amendments to IAS 37*, December 2018, and paragraph 3.20 of January 2020 IASB Staff Paper 22A *Provisions—Research summary*.

Transition requirements for the 2020 amendment

28. The IASB did not require retrospective application of the 2020 amendment. Instead, it specified a modified retrospective approach in which an entity:

    (a) applied the amendment only to contracts for which it had not fulfilled all its obligations at the beginning of the annual reporting period in which it first applied the amendments; and

    (b) did not restate comparative information—instead recognising the cumulative effect of initially applying the amendments as an adjustment to the opening balance of retained earnings or other component of equity, as appropriate, at the date of initial application.[5]

29. The Basis for Conclusions accompanying the amendment explained that:

    > BC20 … The Board concluded that it may be difficult and costly for an entity to obtain the information needed to restate comparative amounts, and the information provided by doing so was unlikely to be sufficiently useful to justify the costs that the entity might incur.

30. In the staff paper discussing possible transition requirements for the 2020 amendment, the staff further noted that:

    (a) onerous contracts are often non-recurring in nature, meaning retrospective application would not generally providers users of financial statements with useful trend information.

    (b) the modified retrospective approach described in paragraph 28 is similar to that permitted by some other IFRS Accounting Standards, such as IFRS 9 *Financial*

[5] Paragraph 94A of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Instruments, IFRS 15 *Revenue from Contracts with Customers*, IFRS 16 *Leases* and IFRIC 23 *Uncertainty over Income Tax Treatments*. [6]

Staff analysis and conclusion

31. We think that the modified retrospective approach prescribed for the 2020 amendment would also be appropriate for the proposed amendment to specify the costs to include in measuring a provision:

    (a) the arguments made for prescribing that approach for the 2020 amendment (as set out in paragraphs 29–30) also apply to the proposed amendment; and

    (b) the proposed amendment flows from the 2020 amendment, and we have not identified any specific reasons for proposing a different approach.

32. This conclusion is reflected in our overall recommendation in paragraphs 40–42.

Proposed consequential amendment to IFRS 3

33. In Agenda Paper 22A *Sweep Issues* for this meeting, we recommend proposing a consequential amendment to IFRS 3 *Business Combinations*—to remove from that Standard an exception to its recognition principle.

34. In this section we consider transition requirements for that consequential amendment.

Background information

35. The issue of a new or amended IFRS Accounting Standard often requires a consequential amendment to IFRS 3.

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6 Paragraphs 17–31 of IFRS Interpretations Committee June 2018 meeting Agenda Paper 6 *Costs considered in assessing whether a contract is onerous (IAS 37)*

36. In several cases—for example, for the consequential amendments to IFRS 3 accompanying the issue of IFRS 15 *Revenue from Contracts with Customers*, IFRS 16 *Leases* and IFRS 17 *Insurance Contracts*—the effective date for the consequential amendment is the same as that of the new or amended Standard, and worded simply. For example, paragraph 64K in IFRS 3 states that:

> 64K IFRS 15 *Revenue from Contracts with Customers*, issued in May 2014, amended paragraph 56. And entity shall apply that amendment when it applies IFRS 15.

37. The transition requirements tend to follow one of two approaches:

    (a) in some cases, there are no specific transition requirements. In such cases, an entity applies paragraph IAS 8—it applies a change in accounting policy retrospectively (as described in paragraphs 4–5 of this paper).

    (b) in other cases, specific transition requirements in IFRS 3 specify that an entity applies the consequential amendments prospectively, that is only to business combinations with an acquisition date on or after the beginning of the period of initial application. An entity does not restate the assets and liabilities it recognised in previous business combinations.

Staff analysis and recommendations

38. We think the transition requirements for the removal of the recognition exception from IFRS 3 need to reflect the transition requirements for the amendments to the requirements supporting the present obligation recognition criterion in IAS 37, as discussed in paragraph 10–12 of this paper. An entity should recognise a provision at the same time irrespective of whether it is incurred as part of a business combination or in another way.

39. In paragraph 11, we conclude that no specific transition requirements should be proposed for those amendments—meaning they would apply retrospectively.

Accordingly, we conclude that there should be no specific transition requirements for the consequential amendment to IFRS 3. This conclusion is reflected in our overall recommendation in paragraphs 40–42.

Staff recommendation and question for the IASB

40. For the reasons in paragraphs 11, 17–23, 31 and 38–39, the staff recommend proposing to require an entity to apply the amendments proposed in this project retrospectively in accordance with IAS 8, with two exceptions.

41. The first exception would apply to the amendment to the discount rate requirements affecting provisions included in the cost of PPE. It would give an entity applying that amendment an exemption similar to that provided for first-time adopters of IFRS Accounting Standards by paragraph D21 of IFRS 1. An entity using the exemption could elect to apply a simplified retrospective approach, whereby in the year of transition it would:

(a) restate the provision applying the amended IAS 37 at the start of the first period for which it provides comparative information; and

(b) apportion the amount by which it adjusts the provision at that date between the related PPE and retained earnings:

(i) assuming the current discount rate(s) and estimates of cash flows used in measuring the provision have not changed since the provision was first recognised; and

(ii) using current estimates of the useful life of the PPE.

42. The second exception would apply to the amendment specifying the costs to include in measuring a provision. It would require an entity to apply the amendment:

(a) only to obligations that exist on, or arise after, the beginning of the annual reporting period in which the entity first applies that amendment; and

(b) without restating comparative information, and instead recognising the cumulative effect of applying the amendment as an adjustment to the opening balance of retained earnings or other component of equity, as appropriate, at the date of initial application.

Question 1 for the IASB
1 Do you agree with the staff recommendation in paragraphs 40–42?

Amendments to IFRS 1

43. In this section, we consider whether amendments to IFRS 1 are needed for first-time adopters of IFRS Accounting Standards applying the amended version of IAS 37 instead of the existing one.

Reason for considering amendments

44. IFRS 1 requires first-time adopters to apply the requirements of IFRS Accounting Standards retrospectively, subject to specified exceptions and exemptions. When the IASB issues a new Standard or makes significant changes to a Standard, it considers whether it should add further exceptions or exemptions to IFRS 1, or remove any existing exceptions or exemptions.

Staff analysis and conclusions

45. We have not identified a need to add or remove any exceptions or exemptions as a result of the amendments proposed in this project:

    (a) at present, IFRS 1 provides no exceptions to or exemptions from the requirements of IAS 37, other than the exemptions from the requirements of IFRIC 1 described in paragraphs 20–21 of this paper; and

    (b) the amendments proposed in this project would not fundamentally change the requirements of IAS 37 or the procedures or judgements required to apply those requirements.

Staff recommendation and question for the IASB

46. For the reasons in paragraph 45, we recommend the IASB proposes no amendments to IFRS 1 as a result of the amendments proposed in this project.

Question 2 for the IASB
2 Do you agree with the staff recommendation in paragraph 46?

Appendix—Illustrative example of the proposed transition requirements for discount rates[7]

The fact pattern

A1. On 1 January 20X1, an entity acquires an item of property, plant and equipment (PPE) for CU200 with an expected useful life of 10 years. The entity has an obligation to decommission the item of PPE at the end of its useful life and estimates the decommissioning cost to be CU100 at the end of its useful life.[8] The entity initially discounts the provision for decommissioning the item of PPE at a rate of 10%.

A2. On 1 January 20X1, the entity recognises:

- a. an item of PPE at a carrying amount of CU238.55, which comprises:
  - i. CU200 in acquisition cost of the item of PPE; and
  - ii. CU38.55 in cost of decommissioning the item of PPE.
- b. a provision for decommissioning the item of PPE at a carrying amount of CU38.55 (present value of CU100 in year 20Y0 discounted at 10%).

A3. The annual depreciation charge of CU23.86 (CU238.55 / 10) and unwinding of the discount on the decommissioning liability is recognised in profit or loss.

[7] This example illustrates the staff recommendation set out in this paper, particularly in paragraphs 11 and 41. We are not asking the IASB to comment on this example.

[8] For simplicity and illustration purposes, we assume there are no changes in the estimated costs to decommission the item of PPE at the end of its useful life.

A4. On 1 January 20X8, the entity applies the proposed amendments to IAS 37 and determines the new discount rate to be 2%. The proposed amendments become effective for annual reporting periods beginning on or after 1 January 20X8.

Base scenario (no change in discount rate)

A5. Using the information in paragraphs A1–A3, the entity reports the following amounts up to 31 December 20X7:

	1 January	**31 December**						
	20X1	**20X1**	**20X2**	**20X3**	**20X4**	**20X5**	**20X6**	**20X7**
Carrying amount of PPE	238.55	214.70	190.84	166.99	143.13	119.28	95.42	71.57
Provision for decommissioning	(38.55)	(42.41)	(46.65)	(51.32)	(56.45)	(62.09)	(68.30)	(75.13)
Net assets	200.00	172.29	144.19	115.67	86.69	57.19	27.12	(3.57)

	for the year ending 31 December						
	20X1	**20X2**	**20X3**	**20X4**	**20X5**	**20X6**	**20X7**
Depreciation expense	23.86	23.86	23.86	23.86	23.86	23.86	23.86
Interest expense	3.86	4.24	4.67	5.13	5.64	6.21	6.83
Total expense	27.71	28.10	28.52	28.99	29.50	30.06	30.69

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Change in discount rate applied retrospectively

A6. On initial application of the proposed amendments to IAS 37, the entity applies the transition requirements in described in paragraph 42 of this paper as follows:

a. the entity restates the carrying amount of the decommissioning liability at 1 January 20X7 (the beginning of the comparative period) by discounting the expected decommissioning costs of CU100 at a rate of 2%. The new carrying amount of the decommissioning provision is CU92.38.

b. using the current discount rate of 2% and estimates of cash flows used in measuring the provision, the entity restates the cost of the item as if these estimates were used at initial recognition. If the decommissioning liability were discounted at a rate of 2% since initial recognition, the cost of decommissioning added to the cost of the PPE would have been CU82.03 (CU100 discounted at 2% over 10 years). The cost of PPE is therefore increased by CU43.48 (CU82.03 – CU38.55).

c. some of this additional cost would have been recognised in profit or loss through the annual depreciation. Therefore, the entity allocated the additional costs between accumulated depreciation and retained earnings based on the remaining useful life of the item. As such, CU26.09 is allocated to accumulated depreciation and CU6.69 to retained earnings.

A7. On transition, the entity restates the carrying amounts of the decommissioning provision and the item of PPE as follows:

Cost of PPE	43.48	
Accumulated depreciation		(26.09)
Decommissioning provision		(24.08)
Retained earnings	6.69	

A8. The following tables below compare the amounts the entity reports (i) under the base scenario and (ii) after having applied the proposed amendments retrospectively from 20X8 to 20Y0 (including for comparative periods).

	Base scenario (no change in discount rate)					**Change in discount rate applied retrospectively**				
	31 December					**1 January**	**31 December**			
	20X6	**20X7**	**20X8**	**20X9**	**20Y0**	**20X7**	**20X7**	**20X8**	**20X9**	**20Y0**
Carrying amount of PPE	95.42	71.57	47.71	23.86	—	112.81	84.61	56.41	28.20	—
Provision for decommissioning	(68.30)	(75.13)	(82.64)	(90.91)	(100.00)	(92.38)	(94.23)	(96.12)	(98.04)	(100.00)
Net assets	27.12	(3.57)	(34.93)	(67.05)	(100.00)	20.43	(9.62)	(39.71)	(69.84)	(100.00)

	Base scenario (no change in discount rate)					**Change in discount rate applied retrospectively**				
	for the year ending 31 December					**for the year ending 31 December**				
	20X6	**20X7**	**20X8**	**20X9**	**20Y0**	**20X6**	**20X7**	**20X8**	**20X9**	**20Y0**
Depreciation expense	23.86	23.86	23.86	23.86	23.86	28.20	28.20	28.20	28.20	28.20
Interest expense	6.21	6.83	7.51	8.26	9.09	1.81	1.85	1.88	1.92	1.96
Total expenses	30.06	30.69	31.37	32.12	32.95	30.01	30.05	30.09	30.13	30.16