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Provisions—Targeted Improvements

Proposed amendments to

Guidance on implementing IAS 37

Comments to be received by 12 March 2025

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**Guidance on implementing
IAS 37 Provisions, Contingent Liabilities and Contingent Assets**

This guidance accompanies, but is not part of, IAS 37. All paragraph references in this guidance are to paragraphs in IAS 37.

Sections A, B and C are amended as described in each section. Section D is unamended and not reproduced in this exposure draft.

**A Tables—Provisions, contingent liabilities, contingent assets
and reimbursements**

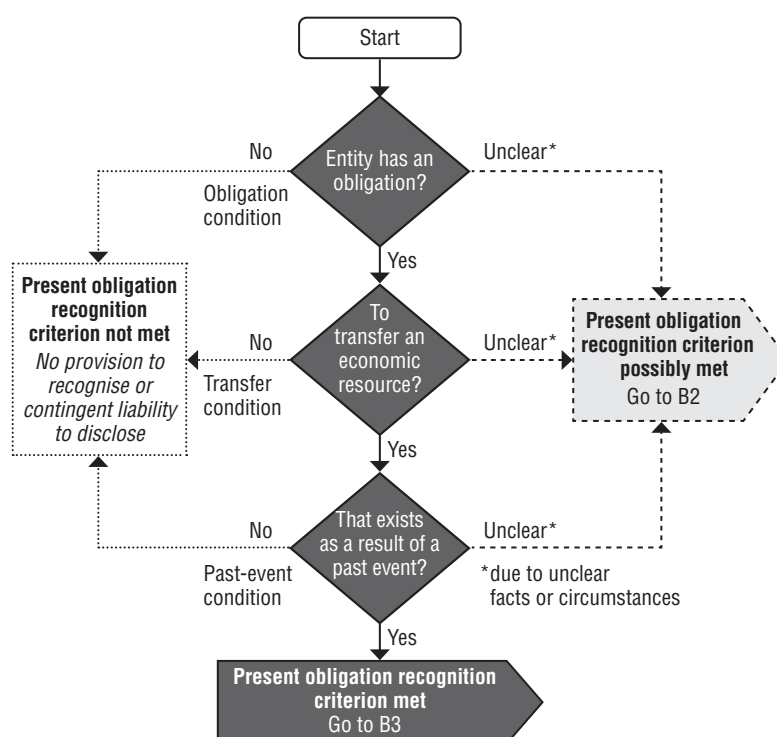
Minor amendments are made to the wording in the tables in Section A, for consistency with amendments to the definition of a liability in IAS 37. These minor amendments are not shown in this exposure draft.

B Decision tree

The decision tree and supporting explanation are deleted and a new three-part decision tree and supporting explanation are added. For ease of reading, the changes to the decision tree are not marked. Other new text is underlined and other deleted text is struck through.

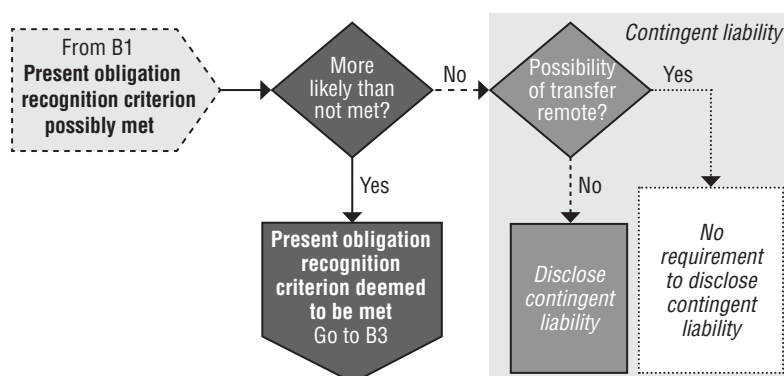
This three-part decision tree summarises the process of applying the three criteria for recognising a provision set out in paragraphs 14–26. ~~The purpose of this diagram is to summarise the main recognition requirements of the Standard for provisions and contingent liabilities.~~

B1 Present obligation recognition criterion (paragraphs 14(a) and 14A–16)

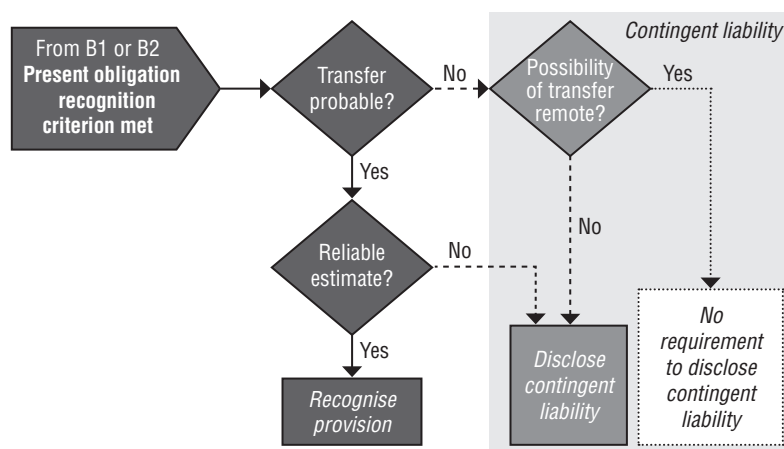


B2 Additional decision needed if it is unclear whether the present obligation recognition criterion is met (paragraphs 15–16)

Note—In rare cases, it is not clear whether there is a present obligation to transfer an economic resource as a result of a past event. In these cases, such an obligation is deemed to exist a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that the a present obligation exists at the end of the reporting period (paragraph 15 of the Standard).



B3 Probable transfer and reliable estimate recognition criteria (paragraphs 14(b), 14(c) and 23–26)



C Examples—Recognition

Example 4 is deleted. Examples 12–15 are added. Examples 1–3, 5A–7 and 10–11B are amended. Examples 8 and 9 were deleted by previous amendments. New text is underlined and deleted text is struck through.

The examples in this section illustrate the application of the recognition requirements in paragraphs 14–26.

All the entities in the examples have financial reporting periods ending on 31 December unless otherwise stated ~~year ends~~. In all cases, it is assumed that a reliable estimate can be made of the amount of any obligation ~~any outflows expected~~. In some examples the circumstances described may have resulted in impairment of the assets – this aspect is not dealt with in the examples.

The cross-references provided in the examples indicate paragraphs of IAS 37 ~~the Standard~~ that are particularly relevant.

References to ‘best estimate’ are to the present value amount, where the effect of the time value of money is material.

Example 1—Warranties

A manufacturer ~~provides~~ ~~gives~~ warranties in connection with the sale at the time of sale to purchasers of its products. The warranties are provided within the contract for sale of the product (they are not sold separately) and they provide customers with assurance that the product will function as intended. Under the terms of the contract for sale the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale.

Management judges that the manufacturer has no practical ability to avoid complying with the terms of the contract for sale. On past experience, management judges it is probable (ie more likely than not) that there will be some claims under the warranties provided on past sales.

Present obligation to transfer an economic resource as a result of a past obligating event – ~~All three conditions specified in paragraph 14A of IAS 37 are met:~~ ~~The obligating event is the sale of the product with a warranty, which gives rise to a legal obligation.~~

<u>Obligation condition</u>	✓	<u>The contract for sale imposes a responsibility on the manufacturer if it sells defective products (paragraph 14B(a)). The manufacturer owes that responsibility to its customers (paragraph 14B(b)). The manufacturer has no practical ability to avoid discharging its responsibility if it sells defective products (paragraph 14B(c)).</u>
<u>Transfer condition</u>	✓	<u>The obligation has the potential to require the manufacturer to provide repair services or replacement goods to customers (paragraphs 14I–14J).</u>
<u>Past-event condition</u>	✓	<u>On the basis of the available evidence (past experience), management judges it to be more likely than not that the manufacturer has taken the action (selling defective products) as a consequence of which it will have to provide services or goods it would not otherwise have had to provide (paragraphs 14N and 15–16). The past-event condition is met for warranty costs attributable to defective products sold in the past.</u>

A transfer of economic resources ~~An outflow of resources embodying economic benefits in settlement~~ – Probable for the warranties as a whole (see paragraph 24).

Conclusion – A provision is recognised for the best estimate of the costs of repairing or replacing making good under the warranty products sold before the end of the reporting period (see paragraphs 14 and 24).

Example 2A—Contaminated land: legislation virtually certain to be enacted

An entity in the oil industry causes contamination but cleans up only when required to do so under the laws of the particular country in which it operates. One country in which it operates has had no legislation requiring cleaning up, and the entity has been contaminating land in that country for several years. At 31 December 20X0 it is virtually

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certain that a draft law requiring a clean-up of land already contaminated will be enacted shortly after the year-end. Management judges that the entity will have no practical ability to avoid complying with the law.

Present obligation to transfer an economic resource as a result of a past obligating event – ~~All three conditions specified in paragraph 14A of IAS 37 are met: The obligating event is the contamination of the land because of the virtual certainty of legislation requiring cleaning up.~~

Obligation condition	✓	<u>An obligation arises when legislation is virtually certain to be enacted as drafted (paragraph 14G). Legislation that is virtually certain to be enacted imposes a responsibility on the entity if it contaminates land (paragraph 14B(a)). The entity owes that responsibility to the country’s government, which acts on behalf of society at large (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it contaminates land (paragraph 14B(c)).</u>
Transfer condition	✓	<u>The entity’s obligation is to provide clean-up services (paragraph 14I).</u>
Past-event condition	✓	<u>The entity has taken the action (contaminating land) as a consequence of which it will have to provide clean-up services it would not otherwise have had to provide (paragraph 14N). The past-event condition is met for clean-up costs attributable to contamination caused before the end of the reporting period.</u>

~~A transfer of economic resources An outflow of resources embodying economic benefits in settlement~~ – Probable.

Conclusion – A provision is recognised at 31 December 20X0 for the best estimate of the costs of cleaning up contamination caused before that date ~~the clean-up (see paragraphs 14 and 22).~~

Example 2B—Contaminated land and constructive obligation

An entity in the oil industry causes contamination and operates in a country where there is no environmental legislation. However, the entity has a widely published environmental policy in which it undertakes to clean up all contamination that it causes. The entity has a record of honouring this published policy. Management judges that by publishing the policy and honouring it in the past, the entity has created a valid expectation in society at large that it will honour the policy in the future and therefore has no practical ability to avoid doing so. The entity has contaminated land and has not yet cleaned it up.

Present obligation to transfer an economic resource as a result of a past obligating event – ~~All three conditions specified in paragraph 14A of IAS 37 are met: The obligating event is the contamination of the land, which gives rise to a constructive obligation because the conduct of the entity has created a valid expectation on the part of those affected by it that the entity will clean up contamination.~~

Obligation condition	✓	The entity's published policy imposes a responsibility on the entity if it contaminates land (paragraph 14B(a)). The entity owes that responsibility to the country's government, which acts on behalf of society at large (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it contaminates land (paragraphs 14B(c) and 14F(b)).
Transfer condition	✓	The entity's obligation is to provide clean-up services (paragraph 14I).
Past-event condition	✓	The entity has taken the action (contaminating land) as a consequence of which it will have to provide clean-up services it would not otherwise have had to provide (paragraph 14N). The past-event condition is met for clean-up costs attributable to contamination caused before the end of the reporting period.

~~A transfer of economic resources An outflow of resources embodying economic benefits in settlement~~ – Probable.

~~Conclusion~~ – A provision is recognised for the best estimate of the costs of cleaning up contamination caused before the end of the reporting period ~~clean-up~~ (see paragraphs 10 (the definition of a constructive obligation), 14 and 17).

Example 3—Offshore oilfield

An entity operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Management judges that the entity has no practical ability to avoid complying with the terms of the licensing agreement.

Ninety per cent of the eventual costs relate to the removal of the oil rig and restoration of the area damaged by constructing ~~damage caused by building it~~, and 10% per cent arise through the extraction of oil. At the end of the reporting period, the oil rig has been constructed but no oil has been extracted.

Present obligation to transfer an economic resource as a result of a past obligating event – All three conditions specified in paragraph 14A of IAS 37 are met: ~~The construction of the oil rig creates a legal obligation under the terms of the licence to remove the rig and restore the seabed and is thus an obligating event. At the end of the reporting period, however, there is no obligation to rectify the damage that will be caused by extraction of the oil.~~

Obligation condition	✓	The licensing agreement imposes a responsibility on the entity if it constructs an oil rig (paragraph 14B(a)). The entity owes that responsibility to the licensor (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it constructs an oil rig (paragraph 14B(c)).
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Transfer condition	✓	The entity's obligation is to provide oil rig removal and seabed restoration services (paragraph 14I).
Past-event condition	✓	<p>The entity has taken the action (constructing the oil rig) as a consequence of which it will have to provide oil rig removal and seabed restoration services it would not otherwise have had to provide (paragraph 14N). The past-event condition is met for the portion of the total expected costs attributable to removing the oil rig and rectifying damage caused to date (90% of the total expected costs) (paragraph 14O).</p> <p>The entity will incur further costs (10% of the total) as a consequence of extracting oil. The entity has not yet extracted oil, so the past-event condition is not yet met for those further costs (paragraph 14O).</p>

~~A transfer of economic resources~~ ~~An outflow of resources embodying economic benefits in settlement~~ – Probable.

Conclusion – A provision is recognised for the best estimate of 90% ~~ninety per cent~~ of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by ~~constructing building it~~ (see paragraph 14). ~~To comply with the requirements in IAS 16 Property, Plant and Equipment, these~~ These costs are included as part of the cost of the oil rig. ~~A provision for the 10%~~ The 10 per cent of costs that arise through the extraction of oil ~~will be~~ are recognised as a liability when the oil is extracted.

Example 4—Refunds policy

~~[Deleted]~~

~~A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.~~

~~**Present obligation as a result of a past obligating event**—The obligating event is the sale of the product, which gives rise to a constructive obligation because the conduct of the store has created a valid expectation on the part of its customers that the store will refund purchases.~~

~~**An outflow of resources embodying economic benefits in settlement**—Probable, a proportion of goods are returned for refund (see paragraph 24).~~

~~**Conclusion**—A provision is recognised for the best estimate of the costs of refunds (see paragraphs 10 (the definition of a constructive obligation), 14, 17 and 24).~~

Example 5A—Closure of a division: no communication or implementation before end of the reporting period

On 12 December 20X0 the board of an entity decided to close ~~down~~ a division. Closing the division will necessarily entail terminating employee contracts. Employees who have provided at least one year’s service will have a contractual right to receive termination benefits (redundancy payments). Management judges that the entity has no practical ability to avoid its contractual obligations.

Before the end of the reporting period (31 December 20X0) the decision was not communicated to any of those affected and no other steps were taken to implement the decision.

Present obligation to transfer an economic resource as a result of a past obligating event – The three conditions specified in paragraph 14A of IAS 37 are not all met: ~~There has been no obligating event and so there is no obligation.~~

Obligation condition	✓ —	<u>The entity’s contracts with its employees impose a responsibility on the entity if it takes two actions – employing (obtaining services from) a person for at least a year and then terminating the employee’s contract (paragraph 14B(a)). The entity owes that responsibility to its employees (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it takes the two actions – closing the division will necessarily entail paying employee termination benefits (paragraphs 14B(c) and 80(a)).</u>
Transfer condition	✓ —	<u>The entity’s obligation is to pay termination benefits to its employees (paragraph 14I).</u>
Past-event condition	x —	<u>The entity is required to pay employee termination benefits only if it takes two separate actions – employing (obtaining services from) a person for at least a year and then terminating the employee’s contract (paragraph 14Q). At 31 December 20X0 the entity has taken the first action but still has the practical ability to avoid the second action because the criteria set out in paragraph 72 are not met – the entity has not yet started to implement a closure plan or announced the main features of a closure plan to affected employees.</u>

Conclusion – No provision is recognised at 31 December 20X0 ~~(see paragraphs 14 and 72).~~

Example 5B—Closure of a division: communication/implementation before end of the reporting period

On 12 December 20X0 the board of an entity decided to close ~~down~~ a division making a particular product. Closing the division will necessarily entail terminating employee and customer contracts. Employees who have provided at least one year’s service will have a contractual right to receive termination benefits (redundancy payments) and some customers will have a contractual right to receive contract termination penalties.

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Management judges that the entity has no practical ability to avoid its contractual obligations.

On 20 December 20X0 the board agreed a detailed plan for closing ~~down~~ the division, ~~was agreed by the board~~; letters were sent to customers warning them to seek an alternative source of supply, and redundancy notices were sent to the staff of the division.

Present obligation to transfer an economic resource as a result of a past obligating event – All three conditions specified in paragraph 14A of IAS 37 are met: The obligating event is the communication of the decision to the customers and employees, which gives rise to a constructive obligation from that date, because it creates a valid expectation that the division will be closed.

<p>Obligation condition</p>	<p>✓</p>	<p><u>The entity's contracts with its employees impose a responsibility on the entity if it takes two actions – employing (obtaining services from) a person for at least a year and then terminating the employee's contract (paragraph 14B(a)). The entity owes that responsibility to its employees (paragraph 14B(b)).</u></p> <p><u>Similarly, the entity's contracts with some of its customers impose a responsibility on the entity if it takes two actions – entering into the contract with the customer and then terminating the contract. The entity owes that responsibility to its customers.</u></p> <p><u>The entity has no practical ability to avoid discharging its responsibilities if it takes the two actions – closing the division will necessarily entail paying termination benefits and penalties (paragraphs 14B(c) and 80(a)).</u></p>
<p>Transfer condition</p>	<p>✓</p>	<p><u>The entity's obligation is to pay termination benefits to its employees and contract termination penalties to its customers (paragraph 14I).</u></p>
<p>Past-event condition</p>	<p>✓</p>	<p><u>The entity is required to pay employee termination benefits only if it takes two separate actions – employing (obtaining services from) a person for at least a year and then terminating the employee's contract (paragraph 14Q). At 31 December 20X0 the entity has taken the first action and has no practical ability to avoid the second action because the criteria set out in paragraph 72 are met – the entity has a detailed formal plan for closing the division and it has sent redundancy notices to affected employees. The termination benefits are payable in respect of past service from employees – they are not associated with the ongoing activities of the entity (paragraph 80(b)).</u></p> <p><u>By the same logic, the past-event condition is met for the contract termination penalties payable to customers.</u></p>

~~A transfer of economic resources. An outflow of resources embodying economic benefits in settlement – Probable.~~

~~Conclusion – A provision is recognised at 31 December 20X0 for the best estimate of the costs of employee termination benefits and customer contract termination penalties that will be payable as a result of closing the division (see paragraphs 14 and 72).~~

Example 6—Legal requirement to fit smoke filters

~~In 20X0 a government enacts legislation. Under the new legislation, entities that produce smoke in their operations are an entity is required to fit smoke filters to their its factories by 30 June 20X1; to protect the health of factory workers. Entities that fail to comply may be subject to fines. An entity that produces smoke in its operations has not started fitting. The entity has not fitted the smoke filters by 31 December 20X1.~~

~~Management judges that the entity has no practical ability to avoid complying with the terms of the legislation or paying fines that may be charged for non-compliance.~~

(a) At 31 December 20X0, the end of the reporting period

~~Present obligation to transfer an economic resource as a result of a past obligating event – The three conditions specified in paragraph 14A of IAS 37 are not all met: There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.~~

Obligation condition	✓	<p>The legislation imposes responsibilities on the entity if it produces smoke after 30 June 20X1 (paragraph 14B(a)). The entity owes these responsibilities to the government, which acts on behalf of factory workers (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibilities if it produces smoke after 30 June 20X1 (paragraph 14B(c)).</p>
Transfer condition	x ✓	<p>Obligation to fit smoke filters</p> <p>The obligation to fit smoke filters does not meet the transfer condition. It is an obligation to exchange economic resources, not an obligation to transfer an economic resource (paragraph 14L). In buying and fitting the filters, the entity will pay cash and receive property, plant and equipment in exchange.</p> <p>Obligation to pay fines</p> <p>The obligation to pay fines meets the transfer condition. It is an obligation that has the potential to require the entity to pay cash (paragraphs 14I–14J).</p>

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<u>Past-event condition</u>	<u>x</u>	<p><u>The entity has not yet taken the action (producing smoke after 30 June 20X1) as a consequence of which it will have to fit smoke filters or may have to pay fines it would not otherwise have had to pay (paragraph 14N).</u></p> <p><u>The entity has not yet obtained the economic benefits (received the smoke filters) as a consequence of which it will have to pay for the filters (paragraph 14N).</u></p>
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Conclusion – At 31 December 20X0 no ~~No~~-provision is recognised for the costs of either fitting the smoke filters or paying fines (see paragraphs 14 and 17–19).

(b) At 31 December 20X1, the end of the reporting period

Present obligation to transfer an economic resource as a result of a past obligating event – All three conditions specified in paragraph 14A of IAS 37 are now met for the obligation to pay fines, but they are not all met for the obligation to fit smoke filters: There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).

<u>Obligation condition</u>	<u>✓</u>	<u>As for part (a).</u>
<u>Transfer condition</u>	<u>x</u>	<p><u>Obligation to fit smoke filters</u></p> <p><u>As for part (a).</u></p> <p><u>Obligation to pay fines</u></p> <p><u>As for part (a).</u></p>
<u>Past-event condition</u>	<u>✓</u>	<p><u>The entity has taken the action (producing smoke after 30 June 20X1) as a consequence of which it will have to fit smoke filters and may have to pay fines it would not otherwise have had to pay (paragraph 14N).</u></p> <p><u>However, the entity has still not obtained the economic benefits (received the smoke filters) as a consequence of which it will have to pay for the filters (paragraph 14N).</u></p>

~~A transfer of economic resources An outflow of resources embodying economic benefits in settlement~~ – The assessment ~~Assessment of~~ the probability of incurring fines and penalties by non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.

Conclusion – At 31 December 20X1 no ~~No~~-provision is recognised for the costs of fitting smoke filters. However, a provision is recognised for the best estimate of any fines and penalties that are more likely than not to be imposed (see paragraphs 14 and 17–19).

Example 7—Staff retraining as a result of changes in the income tax system

~~A~~ The government ~~has introduced~~ introduces a number of changes to the income tax system that will be effective from 20X2. As a result of these changes, an entity in the financial services sector will need to retrain a large proportion of its administrative and sales ~~staff workforce in order~~ to ensure continued compliance with financial services regulation in the future. The entity is preparing financial statements for the year ended 31 December 20X0. At the end of the reporting period, no retraining of staff has taken place and the entity has not yet entered into any contracts with training providers.

Management judges that the entity has no practical ability to avoid complying with responsibilities imposed by financial services regulation and by contracts with training providers.

Present obligation to transfer an economic resource as a result of a past obligating event – The three conditions specified in paragraph 14A of IAS 37 are not all met: There is no obligation because no obligating event (retraining) has taken place.

Obligation condition	<u>x</u>	<p>Financial services regulation imposes a responsibility on the entity to provide its services to a specified standard (paragraph 14B(a)). The entity will carry out staff retraining to ensure it continues to provide its services to the specified standard in the future. However, the entity will carry out the retraining for its own benefit, to enable it to keep providing services. It owes no responsibility for retraining to another party (paragraph 14B(b)).</p> <p>A contract with a provider of training services would impose responsibilities on the entity that it would owe to the provider and have no practical ability to avoid discharging (paragraph 14B). However, no such contract yet exists.</p>
Transfer condition	<u>x</u>	<p>Retraining staff will involve exchanging economic resources, not transferring an economic resource (paragraph 14L). The entity will pay cash to a training provider and receive training services from the provider in exchange.</p>
Past-event condition	<u>x</u>	<p>The entity has not yet obtained the economic benefits (training services) as a consequence of which it will have to transfer an economic resource (pay the training provider) (paragraph 14N).</p>

Conclusion – No provision is recognised (see paragraphs 14 and 17–19).

Example 8—An onerous contract

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Example 9—A single guarantee

[Deleted]

Example 10—A court case

The law imposes a responsibility on an entity to pay damages if it sells food that poisons consumers. After a wedding in 20X0, ten people died, possibly as a result of food poisoning from products sold by the entity. Legal proceedings ~~have~~ are started seeking damages from the entity but it disputes liability. Up to the date ~~when of authorisation of~~ the financial statements for the year to 31 December 20X0 ~~are~~ authorised for issue, the entity's lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to 31 December 20X1, its lawyers advise that, owing to developments in the case, it is probable that the entity will be found liable. Management judges that the entity will have no practical ability to avoid paying damages if it is found liable.

(a) At 31 December 20X0

Present obligation to transfer an economic resource as a result of a past obligating event – The three conditions specified in paragraph 14A of IAS 37 are not all met: On the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.

Obligation condition	✓	<u>The law imposes a responsibility on the entity if it sells food that poisons consumers (paragraph 14B(a)). The entity owes that responsibility to consumers (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it sells food that poisons consumers (paragraph 14B(c)).</u>
Transfer condition	✓	<u>The entity's obligation is to pay damages to poisoned consumers (paragraph 14I).</u>
Past-event condition	Unclear	<u>The past-event condition is met if in 20X0 the entity has sold food that poisoned consumers (paragraph 14N). It is unclear whether the entity has done so. Accordingly, paragraphs 15–16 apply.</u> <u>On the basis of the evidence available when the 20X0 financial statements are authorised for issue, management judges it is not more likely than not that the entity has sold food that poisoned consumers.</u> <u>It is possible that the entity has a present obligation that arises from a past event. This possible obligation meets the definition of a contingent liability (paragraph 10).</u>

Conclusion – No provision is recognised at 31 December 20X0 (see paragraphs 15 and 16). The matter is disclosed as a contingent liability unless the probability of any ~~transfer~~ outflow is regarded as remote (paragraph 86).

(b) At 31 December 20X1

Present obligation to transfer an economic resource as a result of a past obligating event – All three conditions specified in paragraph 14A of IAS 37 are met or deemed to be met: On the basis of the evidence available, there is a present obligation.

Obligation condition	✓	As for part (a).
Transfer condition	✓	As for part (a).
Past-event condition	Deemed ✓	As for part (a), except that, on the basis of the evidence available when the 20X1 financial statements are authorised for issue, management now judges it is more likely than not that the entity has sold food that poisoned consumers. Consequently, the past-event condition is deemed to have been met (paragraphs 15–16).

~~A transfer of economic resources An outflow of resources embodying economic benefits in settlement~~ – Probable.

Conclusion – A provision is recognised at 31 December 20X1 for the best estimate of the amount to settle the obligation to pay damages for selling food that poisoned consumers (paragraphs 14–16).

Example 11—Repairs and maintenance

Some assets require, in addition to routine maintenance, substantial expenditure every few years for major refits or refurbishment and the replacement of major components. IAS 16 *Property, Plant and Equipment* sets out requirements for ~~gives guidance on~~ allocating expenditure on an asset to its component parts where these components have different useful lives or provide benefits in a different pattern.

Example 11A—Refurbishment costs: no legislative requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. At the end of the reporting period, the lining has been in use for three years.

Present obligation to transfer an economic resource as a result of a past obligating event – The three conditions specified in paragraph 14A of IAS 37 are not all met: There is no present obligation.

Obligation condition	✗	No mechanism is in place that imposes on the entity a responsibility that it owes to another party (paragraph 14B). The entity will replace the lining in the furnace for its own benefit.
Transfer condition	✗	Replacing a furnace lining will involve exchanging economic resources, not transferring an economic resource (paragraph 14L). The entity will pay cash and receive a new lining in exchange.

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Past-event condition	<u>x</u>	The entity has not yet obtained the economic benefits (the replacement lining) as a consequence of which it will have to transfer an economic resource (pay the lining supplier) (paragraph 14N).
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Conclusion – No provision is recognised (see paragraphs 14 and 17–19).

The cost of replacing the lining is not recognised because, at the end of the reporting period, no obligation to replace the lining exists independently of the company's future actions—even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining. Instead of a provision being recognised, the depreciation of the lining takes account of its consumption, ie it is depreciated over five years. The re-lining costs then incurred are added to the cost of the furnace, capitalised with the consumption of each new lining shown by depreciation over the subsequent five years.

Example 11B—Refurbishment costs: legislative requirement

An airline is required by law to overhaul its aircraft once every three years. It is two years since the airline last overhauled its aircraft. Management judges that the airline has no practical ability to avoid complying with the law.

Present obligation to transfer an economic resource as a result of a past obligating event – The three conditions specified in paragraph 14A of IAS 37 are not all met: There is no present obligation.

Obligation condition	<u>✓</u>	A law imposes a responsibility on the airline if it operates aircraft that has not been overhauled for more than three years (paragraph 14B(a)). The airline owes this responsibility to its passengers and to society at large (paragraph 14B(b)). The airline has no practical ability to avoid discharging its responsibility if it operates aircraft that has not been overhauled for more than three years (paragraph 14B(c)).
Transfer condition	<u>x</u>	The obligation to overhaul aircraft is an obligation to exchange economic resources, not an obligation to transfer an economic resource (paragraph 14L). In overhauling the aircraft, the entity will pay cash in exchange for enhancing the future economic benefits embodied in the aircraft.
Past-event condition	<u>x</u>	The entity has not yet taken the action (operating aircraft that has not been overhauled for more than three years) as a consequence of which it will have to overhaul aircraft (paragraph 14N). The entity has not yet obtained the economic benefits (aircraft overhaul services) as a consequence of which it will have to pay for the overhaul (paragraph 14N).

Conclusion – No provision is recognised (see paragraphs 14 and 17–19).

The costs of overhauling aircraft are not recognised as a provision for the same reasons as the cost of replacing the lining is not recognised as a provision in example 11A. Even a legal requirement to overhaul does not make the costs of overhaul a liability, because no obligation exists to overhaul the aircraft independently of the entity's future actions – the entity could avoid the future expenditure by its future actions, for example by selling the aircraft. Instead of a provision being recognised, the depreciation of the aircraft takes account of the future incidence of maintenance costs, ie an amount equivalent to the expected maintenance costs is depreciated over three years.

Example 12—Liabilities arising from participating in a specific market: waste electrical and electronic equipment

In 20X3 a country enacts legislation requiring entities that manufacture and sell specified types of electrical and electronic equipment (specified equipment) in that country to contribute to the costs of disposal of the equipment at the end of its life. One section of the legislation applies to equipment sold before the legislation was enacted (historical equipment). It specifies that the disposal costs for historical equipment will be borne by entities selling specified equipment in 20X5. Costs will be allocated to each entity in proportion to its share of the country's market for specified equipment that year – regardless of whether the entity sold any of the historical equipment, or how much it sold.

An entity that manufactured and sold historical equipment is preparing financial statements for the year ended 31 December 20X3. The entity continues to sell specified equipment and management judges that it has no practical ability to withdraw from the market before 20X5.

Present obligation to transfer an economic resource as a result of a past event – The three conditions specified in paragraph 14A of IAS 37 are not all met:

Obligation condition	✓	The legislation imposes a responsibility on the entity if it sells specified equipment in 20X5 (paragraph 14B(a)). The responsibility is owed to the country's government, which acts on behalf of society at large (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it sells specified equipment in 20X5 (paragraph 14B(c)).
Transfer condition	✓	The entity's obligation is to pay a contribution to disposal costs for historical equipment (paragraph 14I).
Past-event condition	✗	The entity's past manufacture and sale of historical equipment has no bearing on the entity's obligation – disposal costs for historical equipment are allocated without reference to the source of the equipment. Only one action (selling specified equipment in 20X5) will require the entity to transfer an economic resource it would not otherwise have had to transfer (paragraph 14N). The entity has not yet taken this action.

Conclusion – No provision is recognised at 31 December 20X3.

Example 13A—A levy on revenue

Legislation imposes a levy on entities that generate revenue in a specific market. The amount of the levy is a percentage of the revenue an entity generates in the market in the year to 31 December 20X0. However, only entities that are operating in the market on 1 January 20X1 are within the scope of the levy, and the levy is charged in full on that date. An entity receives no economic resources in exchange for paying the levy.

An entity’s reporting period ends on 30 June 20X0. The entity has generated revenue in the market throughout the six months to 30 June 20X0. When preparing the entity’s financial statements for the year to 30 June 20X0 management:

- (a) assesses all the terms of the legislation and concludes that the requirement to pay the levy is a consequence of taking two separate actions—generating revenue in the market in 20X0 and operating in the market on 1 January 20X1. Both actions are required for the levy to be payable.
- (b) judges that the entity has no practical ability to avoid paying the levy if it takes the two actions.
- (c) judges that the entity has no practical ability to avoid the second action because the economic consequences for the entity of exiting the market before 20X1 would be significantly more adverse than the cost of paying the levy charged on revenue generated in 20X0.

Present obligation to transfer an economic resource as a result of a past event – All three conditions specified in paragraph 14A of IAS 37 are met:

Obligation condition	✓	The legislation imposes a responsibility on the entity if it takes two separate actions – generating revenue in the market in 20X0 and operating in the market on 1 January 20X1 (paragraph 14B(a)). The entity owes this responsibility to the government, which acts on behalf of society at large (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it takes the two actions (paragraph 14B(c)).
Transfer condition	✓	The entity’s obligation is to pay a levy without receiving an economic resource in exchange (paragraph 14I).

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<p>Past-event condition</p>	<p>✓</p>	<p>The entity is required to pay a levy if it takes two separate actions—generating revenue in the market in 20X0 and operating in the market on 1 January 20X1. At 30 June 20X0 the entity has taken the first action and has no practical ability to avoid taking the second action (paragraph 14Q).</p> <p>The entity generates revenue throughout the 6 months to 30 June 20X0. Consequently, the past-event condition is met, and the resulting present obligation accumulates, over that time (paragraph 14O). At 30 June 20X0 the entity’s present obligation is to pay the levy attributable to the revenue it has generated by that date.</p>
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A transfer of economic resources in settlement – Probable.

Conclusion – At 30 June 20X0 a provision is recognised for the levy attributable to revenue generated by that date.

Example 13B—A levy on an entity operating as a bank on the last day of its annual reporting period

A government charges a levy on banks. Any entity that is operating as a bank on the last day of its annual reporting period is within the scope of the levy. The amount of the levy is calculated by reference to the amounts in an entity’s statement of financial position at the end of that reporting period. If the reporting period is longer or shorter than 12 months, the levy is increased or reduced proportionately—for example, if an entity has a nine-month reporting period, the levy is 9/12^{ths} of the initial amount calculated. An entity receives no economic resources in exchange for paying the levy.

At the start of an entity’s current annual reporting period, the entity is operating as a bank. Management:

- (a) assesses all the terms of the legislation and concludes that the requirement to pay the levy is a consequence of the entity taking two separate actions—operating in its current annual reporting period and operating as a bank on the last day of that period. Both actions are required for the levy to be payable.
- (b) judges that the entity has no practical ability to avoid paying the levy if it takes the two actions.
- (c) judges that the entity has no practical ability to avoid the second action because the economic consequences for the entity of ceasing banking activities before the end of the annual reporting period would be significantly more adverse than the cost of paying the levy charged for that period.

Present obligation to transfer an economic resource as a result of a past event – All three conditions specified in paragraph 14A of IAS 37 are met:

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Obligation condition	✓	The legislation imposes a responsibility on the entity if it takes two separate actions – operating in its current annual reporting period and operating as a bank on the last day of that period (paragraph 14B(a)). The entity owes the responsibility to the government, which acts on behalf of society at large (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it takes the two actions (paragraph 14B(c)).
Transfer condition	✓	The entity’s obligation is to pay a levy without receiving an economic resource in exchange (paragraph 14I).
Past-event condition	✓	The entity is required to pay a levy if it takes two separate actions – operating in its current annual reporting period and operating as a bank on the last day of that period. From the start of the current annual reporting period, the entity starts to take the first action and has no practical ability to avoid the second action (paragraph 14O). Because the extent of the entity’s obligation depends on the length of its annual reporting period, the present obligation accumulates over the annual reporting period (paragraph 14O).

A transfer of economic resources in settlement – Probable.

Conclusion – At the end of the annual reporting period a provision is recognised for the best estimate of the levy that will be charged for the reporting period.

Example 13C—A property tax

Legislation imposes an annual property tax on land and buildings held for business use. The tax is payable by the party that owns the land and buildings on 31 December each year. The tax is calculated after that date and has to be paid by 30 June in the following year. The owner of the land and buildings on 31 December remains liable to pay the full amount of the tax even if it sells the land and buildings, or changes their use, after that date. The owner receives no economic resources in exchange for paying the tax.

Under the legislation, the amount of tax payable is determined by reference to a specific measure of the value of the land and buildings. The measure is the price paid for the land and buildings by the current owner, increased by the change in a specified price index between the purchase date and the date on which the tax is charged.

On 31 December 20X5 an entity owns and holds for business use land and buildings it bought in 20X0.

When preparing the entity’s financial statements for the year ended 31 December 20X5 management:

- (a) assesses all the terms of the legislation and concludes that the requirement to pay the tax is a consequence of the entity taking only one action—owning and holding land and buildings for business use on 31 December 20X5. Although buying the land and buildings at an earlier date affects the amount of tax payable,

it is not an action required for tax to be payable—the tax is payable regardless of when land and buildings were bought.

- (b) judges that the entity has no practical ability to avoid paying the tax on the land and buildings it owns and holds for business use on 31 December 20X5.

Present obligation to transfer an economic resource as a result of a past event – All three conditions specified in paragraph 14A of IAS 37 are met:

<u>Obligation condition</u>	✓	<u>The legislation imposes a responsibility on the entity if it owns land and buildings on 31 December 20X5 and holds them for business use on that date (paragraph 14B(a)). The entity owes the responsibility to the government, which acts on behalf of society at large (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it meets the ownership and use conditions (paragraph 14B(c)).</u>
<u>Transfer condition</u>	✓	<u>The entity’s obligation is to pay a tax without receiving an economic resource in exchange (paragraph 14I).</u>
<u>Past-event condition</u>	✓	<u>As a consequence of owning land and buildings on 31 December 20X5 and holding them for business use on that date, the entity will have to pay a tax it would not otherwise have had to pay (paragraph 14N). The past-event condition is met on 31 December 20X5.</u>

A transfer of economic resources in settlement – Probable.

Conclusion – A provision is recognised on 31 December 20X5 for the full amount of the tax expected to be charged on land and buildings owned on that date.

Example 14—Negative low-emission vehicle credits

A government’s legislation applies to entities that produce cars for sale in a specific market in the calendar year 20X0. Under the legislation, these entities:

- (a) receive positive credits if in that year they have manufactured cars whose average fuel emissions are lower than a government target; or
- (b) receive negative credits if in that year they have manufactured cars whose average fuel emissions are higher than the target.

The legislation requires an entity that receives negative credits for 20X0 to eliminate those negative credits by obtaining and surrendering positive credits. An entity can obtain positive credits either by buying them from another entity or by generating them itself in 20X1 (by manufacturing in 20X1 cars with average fuel emissions lower than the government target).

Under the legislation, the government cannot force an entity to eliminate its negative credits, but can impose sanctions on an entity that fails to do so. These sanctions would not require payment of fines, or any other transfer of economic resources, but would restrict the entity’s access to the market in 20X2 and later years.

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An entity is preparing its financial statements for the year ended 31 December 20X0. In that year, it has produced vehicles with average fuel emissions higher than the government target, so it will receive negative credits. Management expects that the economic consequences for the entity of restricted market access would be significantly more adverse than the costs of obtaining and surrendering enough positive credits to eliminate the negative credits due for 20X0. Management expects the entity to generate the positive credits itself (thus avoiding the need to buy them) by manufacturing in 20X1 cars with average fuel emissions lower than the government target.

Present obligation to transfer an economic resource as a result of a past event – All three conditions specified in paragraph 14A of IAS 37 are met:

Obligation condition	✓	The legislation imposes a responsibility on the entity if in 20X0 it manufactures cars whose average fuel emissions are higher than the government target (paragraph 14B(a)). The entity owes this responsibility to the government, which acts on behalf of society at large (paragraph 14B(b)). The entity has no practical ability to avoid discharging this responsibility because the economic consequences for the entity of restricted market access are expected to be significantly more adverse than the costs of obtaining and surrendering enough positive credits to eliminate the negative credits due for 20X0 (paragraphs 14B(c) and 14F(a)).
Transfer condition	✓	The entity's obligation is to surrender positive credits. An entity that surrenders positive credits to eliminate negative credits is transferring an economic resource, even if the entity has generated the positive credits as part of its manufacturing activities (paragraph 14I). Positive credits are an economic resource however obtained – they enable an entity to settle an obligation to eliminate negative credits, and if the entity were not required to use the positive credits in this way, it could have sold them to other entities.
Past-event condition	✓	The entity has taken the action as a consequence of which it will have to surrender positive credits it would not otherwise have had to surrender (paragraph 14N). That action is manufacturing in 20X0 cars whose average fuel emissions are higher than the government target.

A transfer of economic resources in settlement – Probable.

Conclusion – At 31 December 20X0 a provision is recognised for the best estimate of the expenditure required to obtain and surrender enough positive credits to eliminate the negative credits due for 20X0.

Example 15—Climate-related commitments

In 20X0 an entity that manufactures household products publicly states its commitments:

- (a) to gradually reduce its annual greenhouse gas emissions, reducing them by at least 60% of their current level by 20X9; and
- (b) to offset its remaining annual emissions in 20X9 and in later years by buying carbon credits and retiring them from the carbon market.

To support its statement, the entity publishes a transition plan setting out how it will gradually modify its manufacturing methods between 20X1 and 20X9 to achieve the 60% reduction in its annual emissions by 20X9. The modifications will involve investing in more energy-efficient processes, buying energy from renewable sources and replacing petroleum-based product ingredients and packaging materials with lower-carbon alternatives. Management is confident that the entity can make all these modifications and continue to sell its products at a profit.

In addition to publishing the transition plan, the entity takes several other actions that publicly affirm its commitments.

Having considered all the facts and circumstances of the entity’s commitments—including the actions it has taken to affirm them—management judges that the entity’s statement has created a valid expectation in society at large that the entity will fulfil the commitments, and hence that it has no practical ability to avoid doing so (paragraph 14F(b)).

The entity is preparing financial statements for the year ended 31 December 20X0.

Present obligation to transfer an economic resource as a result of a past event – The three conditions specified in paragraph 14A of IAS 37 are not all met:

<u>Obligation condition</u>	✓	<p><u>The entity’s public statement of its commitments imposes on the entity responsibilities:</u></p> <ul style="list-style-type: none"> (a) <u>to operate in the future in a way that reduces its annual greenhouse gas emissions; and</u> (b) <u>to offset its remaining emissions if it emits greenhouse gases in 20X9 and later years (paragraph 14B(a)).</u> <p><u>The entity owes those responsibilities to society at large (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibilities (paragraph 14B(c)). The obligations meet the definition of a constructive obligation (paragraph 10).</u></p>
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<p>Transfer condition</p>	<p><u>x</u></p>	<p>Obligation to reduce emissions</p> <p>The entity’s obligation to operate in the future in a way that reduces its greenhouse gas emissions is not an obligation to transfer an economic resource. Although the entity will incur expenditure in changing the way it operates, it will receive other economic resources – for example, property, plant and equipment, energy, product ingredients or packaging materials – in exchange, and will be able to use these resources to manufacture products it can sell at a profit (paragraph 14L).</p>
	<p><u>✓</u></p>	<p>Obligation to offset remaining emissions</p> <p>The entity’s obligation to offset its remaining annual greenhouse gas emissions in 20X9 and later years is an obligation to transfer an economic resource. The entity will be required to buy and retire carbon credits without receiving any economic resources in exchange (paragraph 14I).</p>
<p>Past-event condition</p>	<p><u>x</u></p>	<p>Obligation to offset remaining emissions</p> <p>The entity has not yet taken the action (emitting gases in 20X9 or in a later year) as a consequence of which it will have to buy and retire carbon credits it would not otherwise have had to buy or retire (paragraph 14N).</p>

Conclusion – No provision is recognised at 31 December 20X0.

If the entity emits greenhouse gases in 20X9 and in later years, it will incur a present obligation to offset these past emissions when it emits the gases. If, at that time, the entity has not settled the present obligation and it is probable that it will have to transfer an economic resource to do so, the entity will recognise a provision for the best estimate of the expenditure required.

Although the entity does not recognise a provision for its constructive obligations at 31 December 20X0, the actions it plans to take to fulfil the obligations could affect the amounts at which it measures its other assets and liabilities (for example, its property, plant and equipment), and the information it discloses about them, as required by various IFRS Accounting Standards.



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