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Draft Comment Letter

You can submit your comments on EFRAG's draft comment letter by [To be updated for new website].

Comments should be submitted by [date].

International Accounting Standards Board

7 Westferry Circus, Canary Wharf

London E14 4HD

United Kingdom

[XX Month 202X]

Dear Mr Barckow,

Re: Provisions–Targeted Improvements (Proposed amendments to IAS 37)

On behalf of EFRAG, I am writing to comment on the proposed amendments to IAS 37, *Provisions—Targeted Improvements,* issued by the IASB on 12 November 2024 (the ‘ED’).

This letter is intended to contribute to the IASB’s due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

EFRAG acknowledges that the ED does not propose a fundamental revision of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* but suggests making three targeted improvements with the aim of clarifying current requirements, reduce diversity and change the timing of recognition of some provisions.

EFRAG finds the proposals aiming at clarifying the current requirements on when an entity has a present obligation, in general, useful. [EFRAG's position on changing the timing of recognition of some provisions to be inserted following input from constituents].

EFRAG welcomes the IASB's efforts to provide requirements on the costs to be included in measuring a provision and agrees with the proposals.

EFRAG also appreciates the IASB's efforts to reduce diversity in practice by specifying that the rate an entity uses to discount the future expenditure to its present value should not include non-performance risk. Overall EFRAG agrees with these proposals. EFRAG notes that reflecting non-performance risk in the discount rate(s) could result in counterintuitive information.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Isabel Batista, Vasilis Dionelis, Rasmus Sommer or me.

Yours sincerely,

Wolf Klinz

President of the EFRAG FRB

Appendix - EFRAG's responses to the questions raised in the ED

Criteria on when an obligation is present

Notes to constituents – Summary of proposals in the ED

1 *The ED proposes to amend the criteria for when to recognise a provision by:*

(a) *Updating the definition of a liability in IAS 37 to correspond to the definition included in the Conceptual Framework for Financial Reporting ('the Conceptual Framework').*

(b) *Amending the present obligation criterion to be aligned with the guidance included in the Conceptual Framework. This criterion comprises three conditions:*

(i) ***Condition 1 - The entity has an obligation**. This involves that:*

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

Similar to current IAS 37, a present obligation can be legal or constructive.

- *A legal obligation would typically arise from a contract or legislation. An entity would have no practical ability to avoid discharging its responsibility in relation to a legal obligation if the other party has a legal right to take action against the entity if it fails to discharge the responsibility; and the economic consequences for the entity of not discharging the responsibility are expected to be significantly more adverse than the economic consequences of discharging it.*
- *A constructive obligation could arise when an entity establishes a valid expectation based on for examples past practice.*

(ii) ***Condition 2 - The nature of the entity's obligation is to transfer an economic resource**. An entity can have an obligation to transfer an economic resource if an uncertain future event occurs. The likelihood of the future event does not impact whether an entity has an obligation to transfer an economic resource. However, a provision is only recognised when an outflow is probable. An executory contract is not an obligation to transfer an economic resource unless the terms are unfavourable to the entity – for example an onerous contract.*

(iii) ***Condition 3 - The entity's obligation is a present obligation that exists as a result of a past event.*** *An obligation only becomes present obligation that exists as a result of a past event when the entity has obtained specific economic benefits or taken a specific action and as a consequence will or may have to transfer an economic resource it would not otherwise have had to transfer.*

The ED specifies that if an entity is required to transfer an economic resource only if it takes two (or more) separate actions, the entity incurs a present obligation when it takes the first action and has no practical ability to avoid taking the other action(s).

The ED also specifies that if an entity is required to transfer an economic resource only if it exceeds a specified threshold, a present obligation arises as the entity carries out the activity for which the specified threshold is related. A provision should thus be recognised for the portion of the total expected obligation before the specified threshold is met if it is also probable that an outflow of resources embodying economic benefits will be required to transfer an economic resource to settle the obligation; and a reliable estimate can be made of the amount of the obligation.

(c) *Withdrawing IFRIC 6* Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment *and IFRIC 21* Levies*. The IASB proposes to withdraw both IFRIC 6 and IFRIC 21 because the proposed requirements supporting the present obligation recognition criterion would supersede the requirements in those Interpretations. The Guidance on implementing IAS 37 is proposed to include an example similar to that in IFRIC 6 (Example 12 of the proposed Guidance on implementing IAS 37). The guidance included in IFRIC 21 is inconsistent with the proposed new requirements on when an entity incurs a present obligation if an entity is required to transfer an economic resource only if it takes two (or more) separate actions or if it exceeds a specified threshold. The Guidance on implementing IAS 37 is proposed to include examples of when to recognise a levy that requires a transfer of an economic resource only the entity takes two (or more) separate actions (Example 13A and 13B).*

ED Question 1—Present obligation recognition criterion

The IASB proposes:

- to update the definition of a liability in IAS 37 Provisions, Contingent Liabilities and Contingent Assets to align it with the definition in the Conceptual Framework for Financial Reporting (paragraph 10);

- to align the wording of the recognition criterion that applies that definition (the present obligation recognition criterion) with the updated definition of a liability (paragraph 14(a));
- to amend the requirements for applying that criterion (paragraphs 14A–16 and 72–81); and
- to make minor amendments to other paragraphs in IAS 37 that include words or phrases from the updated definition of a liability (Appendix A).

The proposals include withdrawing IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* and IFRIC 21 *Levies* (paragraph 108).

Paragraphs BC3–BC54 and BC86 of the Basis for Conclusions and Appendix A to the Basis for Conclusions explain the IASB's reasoning for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, which aspects do you disagree with and what would you suggest instead?

EFRAG's response

2 EFRAG notes that the ED proposes to change requirements on when a present obligation exists as a result of a past event:

(a) when an entity has an obligation to transfer an economic resource only if it takes two (or more) separate actions. In such situations, the past-event condition is met when the entity has taken the first action (or any of the actions) and has no practical ability to avoid taking the second action (or all the remaining actions);

(b) when an entity has an obligation to transfer an economic resource only if a measure of its activity in a period (the assessment period) exceeds a specific threshold. In such situations, the action that meets the past event condition is the activity that contributes to the total activity on which the amount of the transfer is assessed. At any date within the assessment period, the present obligation is a portion of the total expected obligation for the assessment period. It is the portion attributable to the activity carried out to date.

3 The outcomes of these two requirements are different. If the entity has already done something that could trigger a transfer of an economic resource if the entity is also doing something in the future, the outcome could depend on whether the 'thing' the entity may be doing in the future is considered as a second action or a continuation of an activity that exceeds a specific threshold. As stated in the Basis for Conclusions accompanying the ED,

the management will have to reach a conclusion on what the 'thing' is by assessing all the relevant facts of the mechanism.

4 EFRAG acknowledges that there could be arguments both in favour and against the two amendments listed in paragraph 2. The arguments could be different for the two amendments and could depend on the type of provision, including whether the provision would relate to a reciprocal or non-reciprocal transfer (which are transfers of an entity from which it receives no economic resources in exchanges—such as the levy on revenue included as Example 13A in the proposed Guidance on implementing IAS 37).

5 However, although the arguments are different, they are also interlinked. Accordingly, EFRAG is presenting below arguments in favour and against the two proposals in a combined manner.

6 In favour of the proposals included in the ED, EFRAG notes that it could be argued that the proposals would result in more useful information based on an assessment of the relevance, faithful representation, comparability and the understandability of the resulting information.

(a) **Assessment of the relevance of the information.** As it appears from several academic studies, including a study sponsored by EFRAG[1], the primary financial statement considered by professional equity investors first is most often the statement of profit or loss. The reported performance of an entity is used to estimate future performance (and cash flows). Professional equity investors and debt providers tend to prefer information reflecting 'persistent' or 'recurring' earnings[2]. An implication of this could be that the reported earnings is most relevant when expenses are recognised in the same period as the related income ('matching'). This could provide information on margins that would best reflect future margins. Accordingly, if a levy, for example, depends on two factors: the revenue earned in 20X1 and whether the entity operates on 1 January 20X2, it seems to result in the most relevant information for assessing the entity's performance in 20X1 to recognise the expenses associated with the levy in 20X1, when the revenue is earned, rather than in 20X2, if the entity has no practical ability not to operate on

[1] See https://www.efrag.org/en/news-and-calendar/financial-reporting-publications#23692

[2] See, for example: The use of information by capital providers—Implications for standard setting (EFRAG Short Discussion Series).

1 January 20X2. Similarly, if an entity has to pay an amount if it over a two-year period would exceed a threshold for carbon dioxide emission, it would result in the most relevant information for estimating future margins to recognise the levy over time as the entity is emitting carbon dioxide, if it the emission is expected to exceed the threshold within the two years. Recognising the expenses related to the levy in the same period as the resulting revenue is earned will result in margins being reporting that could be assumed to be more reflective of future margins compared to an alternative recognition of the expenses and, hence, could be seen as providing more relevant information to predict financial performance and cash flows from a user perspective. This also applies if a levy is based on the ownership or usage of an asset. Recognising the expense related to the levy in the periods in which the asset is being owned or used would better reflect the benefits (margins) of having owned or used the asset in a particular period. For example, if an entity is using a particular asset in a period and as a result will have to pay a levy in the next period (if it is still operating), the profitability reported in the financial statements would be unsustainable unless the amount an entity would have to pay in the next period for using the asset is taken into account.

(b) **Assessment of the faithful representation and comparability.** Basing the recognition of a provision for a levy that depends on the entity taking two (or more) separate actions, or the entity reaching a threshold, on the requirements of IFRIC 21 could result in an arbitrary recognition of that liability which does not reflect reality. This happens, for example, when an entity has already taken an action and does not have a practical ability to avoid taking the following actions that would trigger the transfer of an economic resource. For example, in the EU, it happens that Member States can decide the specific date in a year at which an entity should be operating to be covered by a particular levy (that otherwise apply to all entities operating within the EU). If that levy is related to economic benefits the entity has received in the past year, or an action the entity has taken in the past year, and the entity does not have a practical ability not to operate in the following year, it does not reflect reality that entities in different jurisdictions are recognising a liability at different dates. Also, it does not result in comparable information that some entities are recognising a provision for the levy later than others. Similarly, in the example of an entity exceeding a threshold provided above in paragraph 6(a), recognising the levy in the year when the threshold will be reached, if it is expected to be reached in

either the first or the second year, could also be considered to result in a 'random' allocation of the expenses.

(c) **Assessment of the understandability of the information.** It could be argued that the proposals would result in more understandable information based on the input received from users in response to IFRIC 21 and as the outcome could seem more consistent with the outcome of other Accounting Standards.

(i) **Input received from users in response to IFRIC 21**. As mentioned in the ED, the provisions for costs, affected by the proposals, would often be levies that are payable only if an entity takes two separate actions or if a measure of its activity in a specific period exceeds a specific threshold. If follows from IFRIC 21 that such levies should only be recognised when the entity has taken the last action. Input received from users when IFRIC 21 was issued, was that the IFRIC 21 requirements did not result in the most useful information. As noted in EFRAG's endorsement advise on IFRIC 21, levies are often regarded as a charge that relates to a period of time and many believe that a progressive recognition of an expense would be better understood by users. EFRAG accordingly supported the changes to the Conceptual Framework made in 2018, which the proposals in the ED now reflect.

(ii) **the outcome of the proposals could seem more consistent with other Accounting Standards** than the current requirements reflected in IFRIC 21.

The outcome of the proposals on when a liability exists in cases where an entity is only required to transfer an economic resource if it takes two (or more) separate actions, could seem more consistent with other Accounting Standards such as:

- IAS 19 *Employee Benefits*. Par. 62 of IAS 19 notes that a defined benefit plan may permit an entity to terminate its obligation under the plan. Nevertheless, it is usually difficult for an entity to terminate its obligation under a plan (without payment) if employees are to be retained. Therefore, in the absence of evidence to the contrary, accounting for post-employment benefits assumes that an entity that is currently promising such benefits will continue to do so over the remaining working lives of employees.

- IFRS 2 *Share-based Payment*. Par. 19 of IFRS 2 states that (despite a grant of equity instruments might be conditional upon satisfying specified vesting conditions) an entity shall recognise an amount for the goods or services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest and shall revise that estimate, if necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates. Similarly, for cash-settled share-based payment, par. 33B or IFRS 2 states that an entity shall recognise an amount for the goods or services received during the vesting period. That amount shall be based on the best available estimate of the number of awards that are expected to vest.
- The prospective IFRS Accounting Standard on rate-regulated activities ('RRA'). This prospective Standard will require an entity to recognise a regulatory liability when it has an obligation to deduct an amount in determining the regulated rate in a future period. This recognition principle is built on the premise that the revenue an entity has recognised under IFRS 15 *Contracts with Customers* includes an amount that will provide part of the total allowed compensation for goods or services to be supplied in the future. The recognition of a regulatory liability according to the prospective RRA Accounting Standard is based on the assessment that an entity has received economic benefits (revenue) and as a consequence will have to transfer an economic resource that it would not otherwise have had to transfer. It could be argued that because a reduction in the regulated rate to be charged to customers in future periods will only have an effect if the entity is generating revenue for which the regulated rate applies in future periods, the obligation is "conditioned" on the generation of future revenue. This could be analogised with the example included in paragraph 9 of IFRIC 21 where the obligation to pay a levy is the generation of revenue in the current period, but the measurement of that levy is based on the revenue that was generated in a previous period.

- IFRS 3 *Business Combinations*. According to par. 39 and 40 of IFRS 3, an acquirer shall recognise a liability (or an equity instrument) from a contingent consideration arrangement in a business combination at the acquisition date.

The proposed requirements could be argued to be both consistent and inconsistent with requirements included in IFRS 16 *Leases* and IAS 32 *Financial instruments: Presentation* depending on how requirements in these standards and the proposals are interpreted.

- IFRS 16 requires that a liability for variable lease payments is only recognised in the period in which the event or condition that triggers the payment occurs (par. 28 (b) of IFRS 16) unless the variable payment depends on an index or a rate or the variable clauses do not have real economic substance (par. B42 of IFRS 16). If the reference to 'no practical ability to avoid' in the proposals is considered similar to the reference in IFRS 16 to 'no have real economic substance', the proposals could be considered to be consistent with the requirements in IFRS 16 (see also below regarding the illustrative examples accompanying IAS 34 *Interim Financial Reporting*). If not, it could be argued that the current requirements reflected in IFRIC 21 are more similar to the requirements in IFRS 16 compared with the proposals.
- IAS 32 par. 25 notes that a financial instrument may require the entity to deliver cash or another financial asset, or otherwise to settle it in such a way that it would be a financial liability, in the event of the occurrence or non-occurrence of uncertain future events (or on the outcome of uncertain circumstances). When this is the case, a financial liability is (only) recognised when these future events (or circumstances) are beyond the control of both the issuer and the holder of the instrument. If the reference to 'no practical ability to avoid' in the proposals is considered similar to the reference in IAS 32 to 'beyond the control of both the issuer and the holder of the instrument', the proposals could be considered to be consistent with the requirements in IAS 32. If 'beyond the control of both the issuer and the holder of the instrument' is considered more narrowly than 'no practical ability to avoid', the

current requirements reflected in IFRIC 21 could be considered to be more consistent with the IAS 32 requirements than the proposals.

The outcome of the proposals stating that a present obligation arises as the entity carries out activity for which a specified threshold is related, could seem more consistent with other IFRS Accounting Standards such as:

- IAS 12 *Income Taxes*. Par. 49 of IAS 12 states that when different tax rates apply to different levels of taxable income, deferred tax assets and liabilities are measured using the average rates that are expected to apply to the taxable profit (tax loss) of the periods in which the temporary differences are expected to reverse. (Unlike the proposals, the requirements in IAS 12 are considered in relation to the measurement of current and deferred tax assets and liabilities).
- IAS 19. Par. 20 of IAS 19 states that profit-sharing plans create a constructive obligation as employees render service that increases the amount to be paid if they remain in service until the end of the specified period.
- The illustrative examples accompanying IAS 34 *Interim Financial Reporting*. In paragraph B7 it is stated that variable lease payments based on sales can be an example of a legal or constructive obligation that is recognised as a liability. I 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.

7 Against the proposals included in the ED, EFRAG notes that the proposals will result in less useful information based on an assessment of the relevance, faithful representation, comparability and understandability of the resulting information.

(a) **Assessment of the relevance of the information**. One of the main arguments presented above for considering that the proposals would result in more relevant information was that the proposals would result in the reporting of margins that would be more relevant for predicting future margins than the current requirements in IFRIC 21. It could, however, be argued that the proposals would not be more useful

for that purpose. The proposals will affect the timing of recognising some levies. Although the amount to be paid following a levy may be linked to, for example, the revenue generated by an entity in a previous period or the use of an asset in a previous period, levies are non-reciprocal transfers. Accordingly, the payment of a levy is not something that will bring additional resources to an entity and the concept of trying to include in the same period income and the expenses related to generating this income, is not useful for levies. A levy relates to the period in which it is chargeable (that is the entity has performed all the activities and taken all the actions that will result in it having to pay a levy – also actions the entity has no practical ability to avoid) and presenting it differently would not provide the most relevant information. For example, even when a levy depends on revenue generated (as in the example included in paragraph 6(a) above), the levy is not related to the period in which the revenue is generated. The revenue generated is just used to find a manner to divide the total amount needed by the relevant authority amongst entities. This is also reflected by the fact that for some types of levies the percentage used to calculate the amount to be paid in relation to a levy is only be set by the relevant authority after an entity has conducted the activity on which the levy is based. This is because the levy is used by the authority to collect 'sufficient funds'. The amount an entity would have to pay is therefore (partially) unrelated to the activities of the entity and an entity may therefore not even be able to adequately take an amount it will have to pay in the future into consideration when deciding on which actions to take. Trying to take levy payments into account when assessing margins may therefore not be useful for assessing future margins.

(b) **Assessment of the faithful representation of the information.** In relation to levies, it could be argued that the proposals would reduce the faithful representation of the information provided as they confuse recognition and measurement of a levy, as they would result in additional measurement uncertainty and as they would result in the recognition of liabilities that do not exist.

   (i) **Confusion of recognition and measurement**. As stated above under (a), it could be argued that a levy relates to the period in which it is chargeable. Trying to allocate the expenses to the period from which the figures used to calculate the levy are based confuses recognition and measurement. In addition to not providing the most relevant information, it could also be argued not to result in the best faithful representation.

(ii) **Additional measurement uncertainty**. The proposals will result in earlier recognition of provisions when an entity is required to transfer an economic resource only if it takes two (or more) separate actions and when an entity is required to transfer an economic resource only if it exceeds a specified threshold. When this is the case, an entity will typically have to estimate the amount it will be required to transfer. As the amount to be transferred could depend on many different circumstances which could be difficult for an entity to predict and estimate, the measurement uncertainty could be considerably. For example, as mentioned above it could be that the authorities have not even set all the parameters necessary to calculate the amount to be paid when the provision has to be recognised following the proposals in the ED. This may make the information less useful. In this regard it should also be noted that although IAS 37 notes that a provision should not be recognised if a reliable estimate cannot be made, it also notes that this only happens in extremely rare circumstances.

(iii) On the other hand, it could also be argued that estimation uncertainty exists in many other cases and as stated in paragraph 2.19 of the Conceptual Framework for Financial Reporting, the use of reasonable estimates is an essential part of the preparation of financial information and does not undermine the usefulness of the information if the estimates are clearly and accurately described and explained. Even a high level of measurement uncertainty does not necessarily prevent such an estimate from providing useful information.

(iv) **Recognition of liabilities that do not exist**. It follows from paragraph 5.5 of the Conceptual Framework that the recognition of assets or liabilities arising from transactions or other events sometimes results in the simultaneous recognition of both income and related expenses (‘matching’). It, however, also follows that ‘matching’ should not result in allowing the recognition in the statement of financial position of items that do not meet the definition of assets or liabilities. It could be argued that the proposals could result in recognising a liability that would not meet the definition of a liability in the Conceptual Framework. This happens when an entity has an obligation to transfer an economic resource only if a measure of its activity in a period exceeds a specific threshold. An example of an activity that would trigger the payment of a levy could the emission of carbon dioxide. The ED and the

accompanying Basis for Conclusions seem to argue that the emission of carbon dioxide is one action that is completed over time. However, the emission of each carbon dioxide particle could also be seen as separate actions. If this would be the case, the definition of a liability would only be met when the entity would not have a practical ability to avoid exceeding the threshold. The ED could result in the recognition of a liability even when an entity, through its future actions, has a practical ability to avoid exceeding the threshold and thus avoiding transferring an economic resource.

In cases where an entity has an obligation to transfer an economic resource only if it takes two (or more) separate actions, the proposed requirements will result in only provisions meeting the definition of a liability in the Conceptual Framework being recognised. However, this would still mean that liabilities could be recognised which would not result in the transfer of an economic resource. This can happen when an entity has taken the first action and assesses that it does not have a practical ability to avoid taking the remaining actions. But then something unexpected can happen (for example, the entity can unexpectedly go bankrupt) and the actions that were once considered practical unavoidable, have been avoided.

However, as noted above, several current standards such as IAS 19 and IFRS 2 also result in the recognition of a liability that may not result in an outflow of resources and in some circumstances the requirements in these standards could also be argued to result in the recognition of a liability an entity through its future actions has a practical ability to avoid. This illustrates that it might be preferable to sometimes have requirements that result in the recognition of assets and liabilities that do not meet the definitions of assets and liabilities in the Conceptual Framework. As specified in paragraph SP1.3 of the Conceptual Framework, to meet the objective of general purpose financial reporting, the IASB may sometimes specify requirements that depart from aspects of the Conceptual Framework.

(c) **Assessment of the comparability of the information**. The requirements following from IFRIC 21 are quite clear on when to recognise a provision. In contrast, the proposals can result in uncertainties related to:

(i) **When an entity does not have a practical ability to avoid taking specific future actions**. For example, a levy could require an entity to pay an amount

based on the rental value of a property it is using. However, the levy would only have to be paid if the entity is still operating in the region in two years. Different assessment on whether the entity would have a practical ability not to operate in the region in two years and similar transactions could accordingly be accounted for differently by different entities.

(ii) **What affects recognition and what affects measurement**. For example, an entity could be required to pay a levy in two years based on the revenue it is generating in the current period. However, entities that are not generating revenue in the current period (e.g. because they will only start operating in the subsequent year), could be required to pay an amount in two years based on some other factors. Different assessments on whether the revenue an entity is generating in the current year is resulting in a present obligation that exists as a result of a past event, or the revenue should only be considered when measuring the obligation. In other words, different assessments could exist of whether a given action results in the entity will or may have to transfer an economic resource it would not otherwise have had to transfer. In the provided example, one view could be that the fact the entity is generating revenue in a particular period does not result in the entity having to transfer economic resources it would otherwise not have had to transfer. This is because, if the entity would not have generated any revenue, it would anyway have to pay an amount in two years (based on something else). This view results in the entity not recognising a provision for the levy but is only using the revenue generated in the current period to measure the liability when this would be recognised. Another view could be that as the entity is operating in the current period, any additional amount of revenue the entity is generating results in the entity having to transfer an economic resource in two years that it would not otherwise have had to transfer. This view results in the entity recognising a liability for the levy it will have to pay in two years (assuming that it has no practical ability to cease its operations within two years).

(iii) **Whether an entity has an obligation to transfer an economic resource only if a measure of its activities in a period exceeds a specific threshold or whether an entity has an obligation has an obligation to transfer an economic resource only if it takes two (or more) separate actions.** As the accounting treatment resulting from the proposed requirements in the ED would be different depending on whether something is considered as an

activity crossing a threshold or a separate action of an entity, the categorisation of an activity/action would be important. There could be differences in judgement on this. For example, if it is accepted that an entity within a two-year period could emit smoke that would not be sufficiently clean, but if it does it twice, it would have to pay an amount to the authorities. If an entity expects that it will emit unclean smoke twice within the two-year period, but has the practical ability to avoid doing so, should the entity recognise a provision when it emits unclean smoke for the first time in the two-year period? EFRAG expects that there could be different assessments on this which would reduce comparability between entities.

(d) **Assessment of the understandability of the information.** It was argued above that the proposals would result in more understandable information because the requirements would result in more similar information as that resulting from other IFRS Accounting Standards. However, except for IAS 12, the other listed IFRS Accounting Standards deal (mainly) with the recognition of a liability related to reciprocal transfers. Accounting in a similar way for economically dissimilar transactions is detrimental to understandability.

EFRAG Questions to Constituents

Paragraphs 5 and 7 list arguments in favour and against the proposals in the ED on when a present obligation exists as a result of a past event.

1.1 Do you have additional arguments in favour and against the proposals?

1.2 Do you support (some of) the proposals, or would you prefer the current requirements as reflected in IFRIC 21? Would your answer depend on the type of provision being considered (e.g. reciprocal versus non-reciprocal transactions)? If so, for which types of provisions would you support/not support the proposals?

1.3 Would the proposals have any economical impact on some sectors (e.g. sectors in which funds have to be set aside to cover provisions)?

8 EFRAG appreciates that the proposed requirements and additional guidance included in the ED on when a provision exists as a result of a past event is helpful. However, EFRAG considers that additional guidance to address the issues mentioned in paragraph 7(c) need to be included, should the IASB move forward with the proposals. EFRAG, for example, notes that Example 13A—A levy on revenue seems to indicate that an entity would have

no practical ability to avoid something if avoiding doing something would be significantly more adverse than the cost of taking a particular action. In the proposals for the amendments for the text of the Accounting Standard, the reference to 'significantly more adverse' is only used in relation to no practical ability to avoid discharging a responsibility. If 'significantly more adverse' could also be used when assessing whether the past event condition is met, that could be useful to specify in the Accounting Standard itself.

9 To make the new standard more understandable, we are also suggesting to:

(a) **Distinguish requirements related to when the definition of a liability**/provision is met (when an obligation exists) **and recognition requirements** (when to recognise that obligation). This means that an entity would first assess whether an obligation exists based on the proposed criterion and then assess whether it should be recognised (for example recognise only when it can be reliably measured).

(b) **Move specific requirements to the application guidance** (e.g. how to consider new legislation, restructuring and when a present obligation exists when an entity is required to transfer an economic resource only if it exceeds a specific threshold (threshold-triggered costs). This suggestion is based on the fact that specific criteria is required to be met for (1) new legislation (virtually certain to be enacted), (2) restructuring (the ED will note specific requirements to be met before a restructuring provision exists and is recognised) and (3) some threshold-triggered costs (where there are two (or more) separate actions.

Costs included in the estimation of the expenditure required to settle a provision

Notes to constituents – Summary of proposals in the ED

10 *The ED proposes to include all direct costs in measuring any type of provision. Specifically, the ED proposes that the expenditure required to settle the entity's present obligation should be the* ***costs that relate directly to settling that obligation****, which consist of both:*

(a) *the incremental costs of settling the obligation; and*

(b) *an allocation of other costs that relate directly to settling obligations of that type.*

11 *Currently, IAS 37 IAS 37 requires an entity to measure a provision at the best estimate of the expenditure required to settle its present obligation but does not specify the type of costs to be included in the measurement of a provision.*

12 *In May 2020 the IASB issued a narrow-scope amendment to IAS 37 that included a similar requirement regarding the costs an entity includes in assessing whether a contract is onerous. In that amendment paragraph 68A was added to IAS 37 and requires an entity to*

include the incremental costs of fulfilling that contract and an allocation of other costs that relate directly to fulfilling contracts—for example, an allocation of the depreciation charge for an item of plant or equipment.

13 *As explained in paragraph BC64 of the Basis for Conclusions, when the IASB developed the May 2020 narrow-scope amendment, some stakeholders questioned whether:*

(a) *an entity that has used the costs set out in paragraph 68A of IAS 37 to determine whether a contract is onerous is required to include the same costs in measuring the resulting onerous contract provision; and*

(b) *whether an entity is also required to include the same types of costs in measuring other types of provisions within the scope of IAS 37.*

14 *At the time, the IASB decided not to respond to the above questions. However, the IASB acknowledged that IAS 37 is silent on which costs an entity includes in measuring an onerous contract provision and, more broadly, in measuring any type of provision within the scope of IAS 37. The proposal clarifies the costs that should be included in estimating the future expenditure required to settle an obligation.*

15 *In paragraph BC66 of the Basis for Conclusions, the IASB explains that:*

(a) *the basis for measuring an onerous contract provision should be consistent with the basis on which the contract has been assessed to be onerous; and*

(b) *the arguments on which the IASB based its conclusions about the costs of fulfilling an onerous contract obligation apply equally to the expenditure required to settle other types of provisions within the scope of IAS 37.*

ED Question 2—Measurement—Expenditure required to settle an obligation

The IASB proposes to specify the costs an entity includes in estimating the future expenditure required to settle an obligation (paragraph 40A).

Paragraphs BC63–BC66 of the Basis for Conclusions explain the IASB’s reasoning for this proposal.

Do you agree with this proposal? Why or why not? If you disagree, what would you suggest instead?

EFRAG's response

General comments

16 EFRAG supports the proposal to specify that direct costs (as described in the ED) should be included in the measure of a provision. The proposal is consistent with the May 2020 amendment to IAS 37 regarding the assessment of an onerous contract. EFRAG assesses that it would not result in the most useful information to consider different types of costs when assessing whether a contract is onerous and when measuring the onerous contract.

17 EFRAG notes that the proposals included in the ED covers all types of provisions and thus not only onerous contracts. However, also for other types of provisions, it would be consistent with other IFRS Accounting Standards where direct costs are included in the acquisition/manufacture cost of an asset and it could also be argued to reflect the best estimate of the expenditure required to settle the present obligation at the end of the reporting period to that it would be in accordance with the current requirements in IAS 37 (paragraph 36) to include an allocation of other costs that relate directly to settling obligations of that type. EFRAG also considers that the proposal will reduce diversity in practice.

EFRAG - Question to Constituents

2.1 Although EFRAG assesses that the proposals related to the expenditure required to settle an obligation will result in useful information, it notes that performing an assessment of the internal cost related to settling obligation of the given type may be associated with uncertainty and cost. These costs could, for example, include the cost of the internal legal department.

Do you foresee any complexity/costly process in determining the costs that relate directly to settling the obligation(s) (which include both incremental costs and other directly attributable costs? Please explain.

Illustrative examples

18 EFRAG considers that it would be useful to include additional application guidance and illustrative examples on the type of costs to be included in the estimation of expenditures required to settle provisions.

19 EFRAG notes that other IFRS Accounting Standards provide examples of the types of costs that are included or excluded (for example IFRS 15 *Revenue from Contracts with Customers*, IAS 16 *Property, Plant and Equipment* and IFRS 17 Insurance Contracts). EFRAG considers that similar guidance, without providing an exhaustive list, should be provided in IAS 37 to

help entities identify the types of incremental costs other costs that relate directly to settling obligations.

Question 3 - The rate to be used to discount future expenditure to their present value and related disclosure requirements

Notes to constituents – Summary of proposals in the ED

Discount rates to be used to discount future expenditure to their present values

Current requirements

20 *When discounting a provision IAS 37* ***does not specify*** *whether the risks specific to the liability also include non-performance risk - the risk that the entity will not settle the liability. If non-performance risk is reflected, the amount at which a liability is measured decreases, ass non-performance risk is reflected by increasing the discount rate and, in turn, reduced present value.*

21 *IAS 37 explains that the non-performance risk associated with a provision might differ from the non-performance risk associated with an entity's other liabilities. For example, regulations governing asset decommissioning and environmental rehabilitation obligations sometimes reduce the non-performance risk associated with these obligations by requiring entities to fund the obligations, or by ranking the obligations higher than other liabilities in a liquidation.*

22 *In the absence of specific requirements in IAS 37 on whether and how to include non-performance risk, practice varies:*

(a) *some entities exclude non-performance risk and apply a risk-free rate, which they typically determine by reference to an observable market proxy for a risk-free rate such as the current yield on a low-risk government bond in a currency consistent with that of the provision.*

(b) *some entities include an entity-specific measure of non-performance risk and apply a 'credit-adjusted' rate (the entity's incremental or average borrowing rate or an observable market proxy for a risk-free rate adjusted for the entity's credit spread).*

(c) *some entities include a market measure of non-performance risk and determine the discount rate by reference to the current market yield (for example for example, AA-rated corporate bonds) on that type of investment.*

23 *An* ***entity that includes non-performance risk in the discount rate recognises smaller provisions*** *than an entity that excludes that risk. The differences can be significant for large long-term provisions, such as the asset decommissioning and environmental rehabilitation*

provisions recognised by entities operating in the power generation, oil and gas, mining, and telecommunications sectors.

24 *Although the proposals prohibit reflecting non-performance risk in the discount rate, an entity should still adjust the discount rate or its cash flow estimates to reflect the uncertainties related to the amount and timing of future cash flows.*

ED proposals (paragraphs 47 and 47A of the ED)

25 *The ED proposes to specify that an entity discounts a provision at a rate that reflects current market assessments of the time value of money, represented by a risk-free rate, **with no adjustment for non-performance risk.** An entity could estimate an appropriate rate by reference to an observable market proxy for a risk-free rate.*

26 *The proposal aims to improve comparability and standardise the discount rates entities use for provisions under IAS 37, by specifying whether and how the rate includes non-performance risk. Currently to make comparisons, investors would need to adjust the amounts one entity reports so they are calculated on the same basis as the amounts the other entity reports. The IASB was informed that the calculations required are sometimes complex, and not all entities disclose the information necessary to make the appropriate adjustments.*

27 *The proposal will also reduce judgement in determining the discount rate and an entity can estimate an appropriate rate by reference to an observable market proxy for a risk-free rate, without having to have adjustments for non-performance risk.*

Pros and cons of including and/or excluding non-performance risk

28 *In reaching its tentative decision to apply a risk-free rate and exclude non-performance risk from the discount rate, the **IASB considered the alternative views of some stakeholders**. In BC76 of the Basis for Conclusions the IASB explains that as further noted in Appendix B, these stakeholders argued that a rate that includes non-performance risk:*

(a) *can be justified conceptually and results in information that could be useful to investors; and*

(b) *can be viewed as consistent with both (i) the measurement objective of IAS 37; and (ii) the requirement in paragraph 47 of IAS 37 to reflect risks 'specific to the liability'.*

29 *A few stakeholders said they would favour including non-performance risk in the discount rate because doing so would make the requirements in IAS 37 for asset decommissioning and associated environmental rehabilitation obligations more consistent with US GAAP*

reporting that requires an entity to measure these obligations using a credit-adjusted discount rate at the date of initial recognition. Including non-performance risk would also be necessary if (the initial) measurement of a provision should reflect the fair value of the provision.

30 *However, the IASB concluded that a rate that excludes non-performance risk also fulfils these criteria. IASB noted that one conceptual difference between provisions within the scope of IAS 37 and liabilities that arise from exchange transactions. Provisions within the scope of IAS 37 (for example, asset decommissioning obligations) typically do not include an obligation for an entity to pay the counterparty compensation for accepting non-performance risk. Therefore, by excluding non-performance risk an entity faithfully represents the fact that it does not incur an expense for transferring that risk.*

31 *The IASB further noted (B78 of the Basis for Conclusions) the* ***following other arguments in support of applying a risk-free rate*** *that excludes non-performance risk:*

(a) *Many stakeholders, including users and preparers of financial statements, supported a rate that can be determined objectively by reference to an observable market rate. In their view, determining non-performance risk could be highly subjective and reduce comparability. Preparers of financial statements have said the adjustment could be difficult and costly to estimate and audit*

(b) *The outcomes of measuring a provision at an amount that reflects the entity's own credit standing can be counterintuitive. An entity with a weak credit standing reports a smaller liability than an entity with a stronger credit standing, and an entity with a deteriorating credit standing reports a reduction in its liabilities.*

32 *On the basis of the above arguments supporting a risk-free rate, the IASB tentatively concluded that non-performance risk should be excluded from the discount rate.*

33 *In relation to the argument listed in paragraph 31(a), it could be questioned whether estimating non-performance risk in relation to a provision would be more difficult than other measurements that include credit risks. For many entities reporting under IFRS observable market credit spreads are available that could be used as a benchmark/proxy for non-performance risk.*

Application guidance

34 *Paragraph BC81 of the Basis for Conclusions explains why the IASB proposes to add* ***no application guidance*** *to IAS 37 on how an entity determines an appropriate risk-free discount rate. The IASB provides the following arguments:*

(a) *practice is already well-established without guidance in IAS 37 with many preparers of financial statements already estimate a risk-free rate for measuring provisions.*

(b) *provisions within the scope of IAS 37 vary widely in their terms and the circumstances of their settlement and the IASB would be unable to develop a set of comprehensive guidance to cover all such cases.*

(c) *several other IFRS Accounting Standards require assets or liabilities to be measured by reference to risk-free interest rates. Any guidance added to IAS 37 could have unintended consequences for those other Standards.*

Disclosure – discount rates

35 *The IASB also proposes to require an entity to disclose:*

(a) *the rate or rates used in measuring the provision; and*

(b) *the approach used to determine those rates.*

36 *The IASB explains (paragraphs BC83-BC85 of the Basis for Conclusions) that the proposed disclosure requirements respond to investor requests. Investors giving feedback on the discount rate requirements in IAS 37 said comparability is impaired not only by diversity in the rates used, but also by a lack of information about those rates.*

37 *Furthermore, investors noted that other IFRS accounting Standards that require entities to measure an asset or a liability using present value cash flow techniques - for example, IAS 19 Employee Benefits and IAS 36 Impairment of Assets - also require entities to disclose the discount rates they have used. The proposed requirement is also consistent with a requirement in IFRS 17 Insurance Contracts to disclose the approach used to determine the discount rates used in measuring insurance contract liabilities.*

38 *Given the fact that this project is limited in the scope (i.e., it only aims to targeted amendments to IAS 37), the IASB decided to not introduce disclosure requirements besides those already required by other IFRS Accounting Standards.*

ED Question 3 – Discount rates

The IASB proposes to specify that an entity discounts the future expenditure required to settle an obligation at a rate (or rates) that reflect(s) the time value of money - represented by a risk-free rate - with no adjustment for non-performance risk (paragraphs 47–47A).

The IASB also proposes to require an entity to disclose the discount rate (or rates) it has used and the approach it has used to determine that rate (or those rates) (paragraph 85(d)).

Paragraphs BC67–BC85 of the Basis for Conclusions and Appendix B to the Basis for Conclusions explain the IASB's reasoning for these proposals. Do you agree with: (a) the proposed discount rate requirements; and (b) the proposed disclosure requirements? Why or why not? If you disagree, what would you suggest instead?

EFRAG's response

General comments

39 EFRAG supports the proposal to specify that an entity should use a risk-free rate[3] (that is, a rate that excludes non-performance risk) to discount a provision within the scope of IAS 37. The proposal will reduce diversity in practice on discounting of provisions under IAS 37 and enhance comparability for IFRS reporting entities.

40 However, EFRAG notes that the IASB decided not to specify how an entity determines an appropriate risk-free rate, meaning that diversity in practice will continue to exist as management will need to apply judgement in determining the appropriate discount rate(s).

41 EFRAG supports the proposal to require an entity to disclose the discount rate (or rates) it has used and the approach it has used to determine that rate (or those rates). This will provide investors with useful information and alleviate concerns on the use of different approaches to determine a risk-free rate(s).

42 EFRAG notes some areas where further clarification is needed on the application of a risk-rate (rates).

Excluding non-performance risk from the rate (rates)

43 EFRAG supports the proposal to apply a risk-free rate (rates) when discounting provisions under IAS 37. The IASB points out that a risk-free rate is more objective as it can be referenced to an observable market rate/ proxy for a risk-free rate as such a current yield on a low-risk government bond. EFRAG notes that currently, entities use a variety of bases for determining discount rates – with some entities using a risk-free rate(s) and others a higher ''credit-adjusted'' rate. Requiring entities to use a risk-free rate(s) will therefore

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[3] Paragraph 47 of IAS 37 requires an entity to use a **pre-tax discount rate** (or rates).

foster comparability amongst IFRS reporting entities. [4] EFRAG, however, notes that instead of using low-risk government bond rates, the Euro short-term rate, or a similar rate that could have a term structure, could be used. EFRAG notes that a liquid market often only exists for instruments extending for a limited number of years into the future. Some provisions, for example related to nuclear waste can be around 100 years. Accordingly, there is a need for being able to extrapolate current rates.

44 EFRAG notes that the IASB decided not to propose to specify how an entity determines an appropriate risk-free rate, acknowledging that various approaches might be appropriate and lead to diversity. In EFRAG's view, the IASB proposal to disclose the approach it has used to determine the rate (or those rates) can alleviate these concerns as investors will have information to be able to compare the provisions of different entities and make any adjustments they consider necessary in their own analysis.

45 Similar to the IASB, EFRAG has heard from feedback its stakeholders that determining non-performance risk could require more judgement and lead to more variability in the discount rates used and therefore reduce comparability. Preparers of financial statements could also find it difficult and costly to estimate the adjustment for non-performance. For users of financial statements, using a risk-free rate should overcome concerns about the subjectivity of credit adjustments to the rate (rates) used.

46 EFRAG also shares the concern noted in paragraph B78 of the Basis for Conclusions that the outcomes of incorporating non-performance risk into the discount rate (rates) are counterintuitive, and entities with a poor credit rating would report smaller liabilities and those with weakening credit ratings would report gains in profit or loss and increases in shareholder wealth. In this regard, EFRAG also notes that IFRS 9 *Financial Instruments* for the measurement of financial liabilities designated as at fair value through profit or loss, requires the amount of changes in the fair value of the financial liability that is attributable to changes in the credit risk of that liability to be presented in other comprehensive income. This requirement was introduced to address the concern raised by many, including users of financial statements, that reflecting these fair value changes in profit or loss is counterintuitive and does not result in useful information (paragraph BCE.41 in the Basis for Conclusions on IFRS 9).

[4] US GAAP which requires including non-performance risk in the discount rate for provisions.

47 That said, EFRAG notes that feedback received has highlighted that some investors, in particular equity analysts, would prefer a requirement to use credit-adjusted rates. These investors argue that conceptually, from the perspective of an equity investor, any economic measure of a liability reflects the possibility that the entity might go bankrupt and, if it does, would avoid having to settle the liability. This means that there would be a transfer of wealth between lenders and equity holders[5]. EFRAG considers that the proposed disclosure on the rate(s) uses and the basis on which the rates are determined will provide investors with information to make the necessary adjustments to the rate(s) in their analysis. Moreover, EFRAG notes that the financial statements are prepared under a going concern assumption, so under the assumption that the entity can settle its liabilities. It could thus be argued that the figures presented should not reflect the possibility of the entity not being able to settle an obligation.

Areas for clarification/amendment on the proposed discount rate (rates)

48 EFRAG notes the following areas for clarification:

(a) The ED only states that non-performance risk should not be reflected in the discount rate(rates). To avoid confusion, EFRAG recommends that the final amendments also state that non-performance risk should **not be reflected** in the expected cash flows of the related provisions.

(b) EFRAG notes that some types of rate-regulated entities could be significantly affected by the proposals as they have long-term provisions. Some of these entities are required to set aside funds for the amounts of provisions. Sometimes regulation describes how the discount rate(s) should be determined for this purpose. When this is the case, entities might prefer to use that discount rate(s) also used for regulatory purposes which has a real economic impact on the entity. [EFRAG has included a question to constituents to gather further insight in such cases].

(c) EFRAG considers the IASB should specify whether inflation adjustments should be reflected in the discount rate. Whether or not inflation is reflected in the discount rate has implications for whether the expenses related to the unwinding of the discounting are considered operating expenses. It is the view of EFRAG that the

[5] For more information on this and also the related decision of the IASB to allow liabilities being measured at fair value, see: Credit Risk in Liability Measurement (Staff paper accompanying IASB Discussion Paper DP/2009/2).

discount rate should not reflect inflation as EFRAG does not consider the unwinding of inflation as a financing expense.

(d) Whether the requirement to use a discount rate not including non-performance risk would fall under fair value measurement. In the view of EFRAG, this would not be the case, and the proposals would accordingly result in a ''day 2'' difference (a loss) when a provision would be acquired in a business combination. The difference would result from the different measurement of a provision at fair value at acquisition date under IFRS 3 *Business Combinations* and the subsequent measurement of the provision(s) under the proposed amendments (which would not reflect non-performance risk).

Disclosure – discount rates

49 EFRAG supports the proposal to require an entity to disclose the discount rate (or rates) it has used and the approach it has used to determine that rate (or those rates). This disclosure proposal is consistent with other IFRS Accounting Standards (for example, IAS 19 *Employee Benefits* and IAS 36 *Impairment of Assets* also require entities to disclose the discount rates they have used).

50 Furthermore, as noted by the IASB in paragraph BC84 of the Basis for Conclusions, investors have noted that comparability of discount rates used in IAS 37 is impaired not only by diversity in the rates used, but also by a lack of information about those rates. The disclosure proposals respond to this request from investors to provide this information.

EFRAG - Questions to constituents

3.1 In cases when regulation describes the rate(s) to be used or determined to discount certain provisions within the scope of IAS 37, do you agree with the proposal to use a risk-free rate(s) or would you prefer to use the rate prescribed by the applicable regulation? Please explain.

Question 4 – Transition requirements and effective date

Notes to constituents – Summary of proposals in the ED

Transition requirements

51 *The IASB does not propose in the ED specific transition requirements for some of the amendments. The ED proposes a general requirement for retrospective application in accordance with IAS 8* Accounting Policies, Changes in Accounting Estimates and Errors *with two simplifying exceptions.*

52 *Paragraph 94C of the ED states that for the proposed amendments, other than those for which the two exceptions apply, an entity shall at* ***transition date*** *(beginning of the annual reporting period for which the entity provides comparative information):*

(a) *identify, recognise and measure provisions as if the entity had always applied the amendments;*

(b) *re-measure the carrying amount of related assets (for example, items of property, plant and equipment or right-of-use assets), if any, as if the entity had always applied the amendments; and*

(c) *recognise any resulting net difference in retained earnings or other component of equity, as appropriate.*

53 *Paragraph 94C of the ED thus clarifies that if an entity adjusts a provision for asset decommissioning, the entity might also need to adjust the carrying amount of the related asset. The requirement for an entity to recognise the net difference as at the transition date in equity clarifies that the entity does not adjust the carrying amount of goodwill acquired in business combinations occurring before that date (subject to the requirements in paragraph 45 of IFRS 3 Business Combinations)*

Retrospective application for the present obligation criterion

54 *As reflected in the [Agenda Paper 22b](#) of the June 2024 IASB meeting, the IASB's view for retrospective application in relation to the proposals related to the present obligation criterion is based on the IASB's 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 in 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.*

Modified retrospective approach for changes in costs included in the measure of a provision (required)

55 *This simplifying exception related to the proposals on how to measure the cost of a provision requires an entity to apply the proposed amendments:*

(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.*

(b) *without restating comparative information. Instead, the entity recognises 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.*

56 *According to paragraph BC91 of the ED, the IASB is proposing this modified retrospective approach because:*

(a) *the IASB required this approach when it amended IAS 37 in 2020 to specify the costs an entity includes in assessing whether a contract is onerous; and*

(b) *the amendments proposed in paragraph 40A follow from the 2020 amendment described in (a). The arguments made in support of the modified retrospective approach specified in the 2020 amendment (see paragraphs BC20–BC21 of the Basis for Conclusions on IAS 37) also apply to the amendment proposed in paragraph 40A.*

Simplified approach for changes in discount rates (option)

57 *In accordance with paragraph BC94 of the ED, the IASB noted that an entity that currently discounts an asset decommissioning or restoration provision at a rate that includes non-performance risk would need to change its accounting policy to use a lower rate, with a resulting increase in the measure of the provision.*

58 *As per paragraph BC95 of the ED, the IASB concluded that applying the change in accounting policy retrospectively could be difficult if the corresponding debit is added to the cost of the related asset for the following reasons:*

(a) *IAS 37 requires an entity to measure a provision using current estimates of the expenditure required to settle the present obligation and a current market assessment of the time value of money. Consequently, the measure of an asset decommissioning or environmental rehabilitation provision can fluctuate between reporting dates due to changes in estimates of the required expenditure or changes in current market interest rates.*

(b) *IFRIC 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities requires the fluctuations described in (a) to be added to, or deducted from, the cost of the related asset. Consequently, the fluctuations are generally recognised in the statement of profit or loss prospectively as the related asset is depreciated over its useful life or becomes impaired. Accordingly, the carrying amount of the asset at the date of transition could depend on when and how estimates of required expenditure and market interest rates fluctuated from the date the decommissioning obligation arose.*

(c) *therefore, retrospective application of the change in accounting policy would necessitate an entity constructing a historical record of every adjustment that would have been made to the asset's cost and accumulated depreciation at each reporting date between initial recognition of the provision and the date of transition.*

59 *As reflected in Agenda paper 22b of the June 2024 IASB meeting, paragraph BC63C of the Basis for Conclusions on IFRS 1* First-time Adoption of International Financial Reporting Standards*, the IASB had concluded that constructing such a historical record would be impracticable for first-time adopters of IFRS Accounting Standards. For this reason, 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. Paragraph D21 of IFRS 1 sets out a simplified retrospective approach for an entity that chooses to use this exemption. Applying that simplified approach, an entity measures the provision at the date of transition in accordance with the requirements in IAS 37 and estimates the amount that would have been included in the cost and accumulated depreciation of the related asset using simplifying assumptions.*

60 *Therefore, as the IASB proposes in the ED an exception to the retrospective application, to the discount rate requirements affecting provisions for asset decommissioning, restoration or similar costs that are added to the cost of the related asset.*

61 *The exception* ***would permit*** *an entity to apply a simplified retrospective approach, whereby in the year of transition the entity would:*

(a) *apply the amended requirements in IAS 37 to restate the provision 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 asset 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 related asset.

62 *Moreover, IFRS 1 requires first-time adopters of IFRS Accounting Standards to apply the requirements retrospectively, with some exceptions. The IASB proposes no changes to the exceptions in IFRS 1 as a result of the proposed amendments.*

Effective date

63 *If the IASB goes ahead with the proposed amendments, it will decide on an effective date for the amendments that gives those applying IAS 37 sufficient time to prepare for the new requirements.*

ED Question 4 – Transition requirements and effective date

4(a) Transition requirements

The IASB proposes transition requirements for the proposed amendments (paragraphs 94B–94E).

Paragraphs BC87–BC100 of the Basis for Conclusions explain the IASB's reasoning for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, which aspects do you disagree with and what would you suggest instead?

4(b) Effective date

If the IASB decides to amend IAS 37, it will decide on an effective date for the amendments that gives those applying IAS 37 sufficient time to prepare for the new requirements.

Do you wish to highlight any factors the IASB should consider in assessing the time needed to prepare for the amendments proposed in this exposure draft?

EFRAG's response

Retrospective application for the amendments to the present obligation recognition criterion

64 The proposed amendments on the present obligation recognition criterion will result in earlier recognition of some provisions (typically provisions for certain levies, climate-related penalties, or variable lease payments).

65 EFRAG generally agrees that retrospective application of a change in accounting policy results in more useful information for users of financial statements. EFRAG also agrees that retrospective application is likely to be practicable for most entities, and that the benefits of retrospective application are likely to exceed the costs. This is because EFRAG considers that, for the types of provisions that are likely to require earlier recognition, the related costs are typically recurring charges and an entity would not be required to gather information about transactions occurring long before the start of the comparative period.

66 Therefore, EFRAG agrees with full retrospective application with regard to the proposal on the present obligation recognition criterion.

Modified retrospective approach for changes in costs included in the measure of a provision

67 EFRAG also agrees with the proposed modified retrospective approach for changes in costs included in the measure of a provision. This is in line with the transition approach included in the amendments to IAS 37 in 2020 to specify the costs an entity includes in assessing whether a contract is onerous. Under the proposed modified approach, an entity would apply the change in accounting policy for the costs it includes in the measure of a provision (1) only to obligations that are not yet settled at the date of initial application[6] and (2) without restating comparatives.

68 Similar to the arguments in support for relief from full retrospective application in the 2020 amendments, EFRAG agrees that it would 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.

69 The proposed transition approach is also similar to that permitted by some other IFRS Accounting Standards, such as IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers*, IFRS 16 *Leases* and IFRIC 23 *Uncertainty over Income Tax Treatments*[7].

Simplified retrospective approach for changes in discount rates (option)

70 As explained below, EFRAG understands that a retrospective approach under IAS 8 would be impractical for changes in discount rates. Therefore, EFRAG supports the proposed

[6] The date of initial application is the beginning of the annual reporting period in which the entity first applies the amendments (paragraph 94B (b) of the ED).

[7] References in June 2018 IFRIC staff paper.

simplified approach. EFRAG notes that the proposal is an option that an entity can elect to apply.

71 The proposed change to the discount rate(s) in paragraph 47 of the ED would result in entities having to recognise a higher provision. The difficulty in retrospective application arises, because many cases where discounting is relevant relate to decommissioning or rehabilitation provisions for which entities would recognise the corresponding debit as an addition to the cost of the property, plant or equipment (PPE) to which the decommissioning or rehabilitation obligation relates, instead of an expense. Retrospective application would require an entity to gather or reconstruct information generated from the time of initial recognition of the provision, which could be several years back if the provision relates to the decommissioning of long-lived assets. This would mean constructing a historical record of every adjustment that would have been made to the asset's cost and accumulated depreciation at each reporting date between initial recognition of the provision and the date of transition. This would be burdensome and costly for entities to do.

72 At the same time, EFRAG considers that the proposed approach is also complex to apply, in particular when the opening balance adjustment for a decommissioning or restoration provision affects the carrying amount of a related asset, and therefore recommends including the example provided in the Appendix of IASB staff paper 22b (June 2024) or a similar example in the proposed amendments, either as an illustrative example or as application guidance. The example would help clarify the proposed simplified retrospective approach and specifically how to allocate costs between accumulated depreciation and retained earnings based on the remaining useful life of the related asset.

73 In addition, EFRAG calls the IASB to consider whether an impairment test under IAS 36 *Impairment of Assets* should be conducted for a related assets impacted by a change in the measurement of provisions due to the proposed discount rate amendments. As the proposals related to the discounting of provisions could result in higher provisions related to decommissioning, restoration and similar liabilities, the cost of the assets to which these decommissioning, restoration and similar liabilities are related should also increase. If these assets are tested for impairment outside a CGU, their increased measurement may trigger impairment.

74 [Based on the above considerations, EFRAG includes a question to constituents regarding the transition requirements.]

Effective date

75 With respect to the effective date, EFRAG agrees with allowing for sufficient time to prepare for the new requirements, with earlier application permitted. [EFRAG asks constituents on input on the effective date].

EFRAG - Questions to Constituents

5.1 Have you identified any possible difficulty in applying the proposed transition requirements, in particular related to the simplified retrospective approach for changes in discount rates? Please explain.

5.2 Have you identified any factors the IASB should consider in assessing the time needed to prepare for the proposals?

Question 5 – Disclosure requirements for subsidiaries without public accountability

Notes to constituents – Summary of proposals in the ED

76 *The IASB proposes in the ED to add to IFRS 19 Subsidiaries without Public Accountability: Disclosures a requirement for an entity to disclose the discount rate(s) used in measuring a provision, but not to add to IFRS 19 a requirement for an entity to disclose the approach used to determine the rate(s).*

77 *According to paragraph BC104 of the ED, this proposal reflects:*

(a) *the guiding principle that information on measurement uncertainties —for example, significant judgements and estimates—is important for eligible subsidiaries;*

(b) *the fact that IFRS 19 requires disclosure of the discount rates used in measuring other assets and liabilities; and*

(c) *the IASB's assessment that the costs of disclosing discount rates used would be low, because the information is readily available and not commercially sensitive.*

78 *It is also noted that IFRS 19 includes most of the requirements in other accounting standards to disclose discount rates, for example the requirements in IAS 36, IFRS 17 are directly required, whereas the requirements in IAS 19 and IFRS 2 are indirectly required through the disclosure of actuarial assumptions or inputs. In addition, IFRS 19 includes all the other disclosure requirements in IAS 37. The IASB considered that it would therefore be consistent with the current requirements in IFRS 19 to require disclosure of the discount rate used in measuring provisions.*

79 *According to paragraph BC105 of the ED, the IASB noted that with the exception of IFRS 17, none of the other requirements in IFRS 19 require disclosure of the approach used to determine the discount rate and concluded that the costs of providing this information would exceed the benefits to the users of eligible subsidiaries' financial statements. The IASB therefore proposed not to include this proposed requirement in IFRS 19.*

ED Question 5—Disclosure requirements for subsidiaries without public accountability

The IASB proposes to add to IFRS 19 *Subsidiaries without Public Accountability: Disclosures* a requirement to disclose the discount rate (or rates) used in measuring a provision, but not to add a requirement to disclose the approach used to determine that rate (or those rates) (Appendix B).

Paragraphs BC101–BC105 of the Basis for Conclusions explain the IASB's reasoning for this proposal.

Do you agree with this proposal? Why or why not? If you disagree, which proposal do you disagree with and what would you suggest instead?

EFRAG's response

80 EFRAG understands that barring IFRS 17 *Insurance Contracts*, none of the other requirements in IFRS 19 require disclosure of the approach used to determine the discount rate. EFRAG also considers that as provisions can often be very large and long-term (e.g., decommissioning provisions), information about the approach an entity has used to determine the discount rate of provisions is likely to be material. As such, EFRAG also sees merit in the proposal to require information about the approach used to determine the discount rate for entities in the scope of IFRS 19.

81 On the other hand, EFRAG notes that for most entities, the manner in which provisions are discounted may not be particularly significant and allowing entities under IFRS 19 not to provide information on the estimation of discount rate could reduce costs for preparers.

82 Taking the above into consideration, EFRAG, on balance, supports the proposed amendments to IFRS 19. EFRAG has included a question to constituents, particularly users of subsidiaries' financial statements, to that effect.

EFRAG - Question to Constituents

5.1 Do you think that disclosing the discount rate (or rates) used in measuring a provision, but not the approach used to determine that rate (or those rates) results in useful information for entities applying IFRS 19? Please explain.

Question 6 - Guidance on implementing IAS 37

Notes to constituents – Summary of proposals in the ED

83 *The ED proposes to amend the Guidance on implementing IAS 37 to:*

(a) *Update the decision tree in Section B so that it reflects the three conditions the present obligation criterion comprises.*

(b) *Update the examples in Section C, including illustrating how the three conditions the present obligation criterion comprises are assessed for the examples.*

(c) *Adding the following examples in Section C:*

(i) *Example 12—Liabilities arising from participating in a specific market: waste electrical and electronic equipment;*

(ii) *Example 13A—A levy on revenue;*

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

(iv) *Example 13C—A property tax;*

(v) *Example 14—Negative low-emission vehicle credits;*

(vi) *Example 15—Climate-related commitments;*

(d) *Removing Example 4—Refunds policy in Section C. This example was removed as it was no longer applicable following the issue of IFRS 15* Revenue from Contracts with Customers*).*

ED Question 6—Guidance on implementing IAS 37 The IASB proposes amendments to the Guidance on implementing IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. It proposes: (e) to expand the decision tree in Section B; (f) to update the analysis in the illustrative examples in Section C; and (g) to add illustrative examples to Section C.

Paragraphs BC55–BC62 of the Basis for Conclusions explain the IASB's reasoning for these proposals.

Do you think the proposed decision tree and examples are helpful in illustrating the application of the requirements? If not, why not?

Do you have any other comments on the proposed decision tree or illustrative examples?

EFRAG's response

84 EFRAG agrees with expending the decision tree in Section B, should the proposed amendments to IAS 37 be pursued.

85 EFRAG also generally agrees with the amended and added examples in Section C, but has the following comments:

(a) Example 3—Offshore oilfield: Similar to the notation used for Example 6, a 'x' could be placed for the past event condition for the part relating to the cost related to extracting oil.

(b) Example 5A—Closure of a division: no communication or implementation before end of the reporting period: To be helpful for similar, but not identical examples, it could be highlighted in the example that an employee is not required to perform additional services for the entity in order to receive the termination benefits.

(c) Example 5B—Closure of a division: communication/implementation before end of the reporting period: For the avoidance of doubt, it could be specified that the entity has notified its customers that it will terminate existing contracts. The current wording could be interpreted as if the entity would just not accept future contracts.

(d) Example 6—Legal requirements to fit smoke filters. In the provided assessment of the past-event condition of the situation as at 31 December 20X1, it could appear as if the entity would have a present obligation to transfer an economic resource as a result of a past event if it had received the smoke filters. While this could be the case, it requires assumptions on when the entity would have paid for these smoke filters (in arrears or in advance), which are not included in the description. In addition, the obligation would likely be a financial liability and the relevance of this part in the Guidance on implementing IAS 37 is therefore questionable.

(e) Example 13A—A levy on revenue. In this example, it appears as if an entity has no practical ability to avoid an action if the economic consequences of avoiding the action would be significantly more adverse than doing the action. In the text of the

Accounting Standard, the reference to 'significantly more adverse' is only used in relation to no practical ability to avoid discharging a responsibility. If 'significantly more adverse' could also be used when assessing whether the past event condition is met, that could be useful to specify in the Accounting Standard itself. This comment also applies to Example 13B—A levy on an entity operating as a bank on the last day of its annual reporting period.

Other comments

Notes to constituents – Summary of proposals in the ED

86 *The ED asks whether respondents have comment on any other aspects of the proposals in the ED.*

Question 7—Other comments

Do you have comments on any other aspects of the proposals in the Exposure Draft?

EFRAG's response

87 EFRAG does not have additional comments to the proposals in the ED than those included in the answers to Questions 1–5.