

AUSTRIAN FINANCIAL REPORTING ADVISORY COMMITTEE  
c/o KAMMER DER STEUERBERATER:INNEN UND WIRTSCHAFTSPRÜFER:INNEN  
AM BELVEDERE 10 | TOP 4  
A-1100 VIENNA  
AUSTRIA

TEL +43 (1) 81173 228  
FAX +43 (1) 81173 100  
E-MAIL [office@frac.at](mailto:office@frac.at)  
WEB <http://www.frac.at>

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Mr. Wolf Klinz  
EFRAG FRB Chair  
EFRAG  
Square de Meeûs 35  
B-1000 Brussels  
Belgium

Comments on the EFRAG Questions on the Exposure Draft " Provisions – Targeted Improvements Proposed Amendments to IAS 37"

Dear Wolf Klinz,

On behalf of the Austrian Financial Reporting Advisory Committee (AFRAC), the privately organised standard-setting body for financial and other corporate reporting in Austria, we appreciate the opportunity to contribute to EFRAG's draft comment letter on the Exposure Draft "Provisions – Targeted Improvements Proposed Amendments to IAS 37" by providing in advance our feedback vis-à-vis the IASB.

Principal authors of this comment letter were Stefan Dankovsky, Daniela Frei, Christian Groß, Christian Höllerschmid, Erich Kandler, Helmut Kerschbaumer (chair), Christoph Krischanitz, and Aslan Milla. In order to ensure a balanced Austrian view on the consultation, these authors have different professional backgrounds.

Best regards,  
Romuald Bertl  
Chairman

## Responses to the questions posed by EFRAG

### General comments

While we support the proposed amendments relating to the measurement of provisions, we have some concerns that the amended recognition criteria will lead to a higher complexity (e.g. required decisions when applying the rules as evidenced in the decision tree included in the implementation guidelines), to a significantly higher need for accounting estimates (e.g. to determine an "action" when applying Para 14Q) and consequently to higher diversity in practice.

In addition, we believe that the existing rules in IAS 37 are sufficient to account for provisions in practice and that "targeted improvements" should be limited to narrow amendments only.

On the other hand, if the Board intends a "modernization" of IAS 37, such a project should be more comprehensive, e.g. it should deal with fundamental issues such as the inclusion of uncertainty in the measurement of a provision.

### ***EFRAG Questions (Recognition)***

*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?***

The arguments in favour and against the proposals appear comprehensive.

One argument against the proposal is that the proposed amendments do not just relate to levies, but to all situations where an obligation to transfer an economic resource depends on a future action and where the entity has no practical ability to avoid taking this future action. This may lead to unintended consequences (see 1.5 below).

#### ***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?***

We neither prefer the current requirements nor do we fully support the proposals.

The arguments for a need to change the current requirements are sufficiently listed in BC13 and BC14. We generally support the need to reconsider the current requirements in IFRIC 21 in light of the definition of a liability in the existing Conceptual Framework. However, we are concerned that the proposed requirements are too far-reaching and complex, and we strongly recommend reconsidering certain parts thereof. We also acknowledge that finding a satisfactory solution may be difficult.

The draft comment letter includes strong arguments both in favour of and against the proposals. In addition, we have the following arguments:

The proposed amendment in Para 14Q is mainly based on the existence of "actions" and their timing and, in our opinion, does not sufficiently consider the type and nature of a levy.

Whether the provision is a reciprocal or non-reciprocal transaction, should be considered when determining the recognition requirements. In addition, we suggest considering also the nature (facts and circumstances) of a specific levy (or generally – a liability).

If it is clear from the nature of a levy that it relates to a certain period and, if activities performed in a different period are only used to measure the payment amount, there should be no need to apply the rules currently proposed in para 14Q. This would prevent the recognition of a provision as described in sections 8 (a) - (d) of the draft Comment Letter. The same should be applied to reciprocal transfers: for reciprocal transfers, a provision should be recognised in the same period when the related benefits have been received. This would be in line with the requirements in IFRS 2 or IAS 19.

Consequently, the proposed requirements in Para 14Q should be applicable only in situations where there is no clear indication from the type and nature of the obligation.

If it is not possible to find a clear solution the Board may consider not to implement IFRIC 21 issues into IAS 37, but to deal with these issues separately, e.g. in a separate standard or together with the project on rate regulated activities.

*1.3 The ED proposes to maintain the requirements that a provision should only be recognised if*

- (1) it is probable that an entity will be required to transfer an economic resource to settle the obligation; and*
- (2) a reliable estimate can be made of the amount of the obligation.*

*It will still be specified that it is only in extremely rare cases that an entity will not be able to make a reliable estimate of the amount of the obligation. Do you consider that these requirements should be amended following the proposals of the ED on when an entity has a present obligation?*

We believe that the existing concept provides robust guidance and we do not see the need for an amendment.

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

As the proposal will generally lead to an earlier recognition of a provision, it will have an impact on sectors where regulations are based on metrics derived from liabilities recognized. Such sectors are mainly, but not exclusively, financial institutions.

In addition, we would like to point out that the earlier recognition of provisions may have an impact on contractual terms such as financial covenants.

1.5 *Could you foresee the proposals resulting in any unintended consequences? If so, which?*

Yes, we are concerned that the proposal may lead to unintended consequences.

Replacing Para 18 and 19 by Para 14N to 14R may have effects, which go beyond the issues dealt with in IFRIC 21. Para 19 did not allow the recognition of a provision if the entity can avoid the future expenditure through future actions, for example by changing its method of operation. The proposed Para 14Q opens this strict rule to allow recognition of a provision in situations, where an obligation to transfer an economic resource depends on a future action and the entity has no practical ability to avoid taking this future action.

We are concerned that the proposed amendments could require the recognition of a provision in situations that go beyond those in IFRIC 21. Basically, recognition of a provision may become obligatory in situations where an entity is required by a legal or constructive obligation to incur expenses to ensure future operations.

This could constitute a significant change as compared to current practice/requirements and might have a material effect on the results and financial position of companies affected by this change.

Examples of such situations are:

- Based on an underlying contract with the government, an operator of public infrastructure (e.g. highways, gas or electricity grids) needs to keep the infrastructure in a certain condition, which requires certain maintenance work not eligible for capitalization and which is caused by the condition of the infrastructure assets as at the reporting date. Currently, if the maintenance work is not yet executed, a provision is recognized for expenses expected to be required within the earliest possible termination period, because any expenditure beyond the termination period would only be incurred if the entity continued to operate the infrastructure beyond the current period and would therefore be conditional on the entity's future actions. According to the proposed wording, the period to be considered in measuring such a provision could be significantly longer (and is likely subject to discretion).
- We believe that regulatory liabilities (e.g. of grid operators) from fees charged to customers higher than the costs actually incurred, would need to be recognized under the amended IAS 37 rules.<sup>1</sup>

1.6 *Do your answers to the question above depend on whether you consider the proposed requirements in relation to the annual financial report or in relation to an interim financial report? If so, please specify how your answers differ for the two types of financial reports.*

The answers to the questions above also apply for preparing interim financial statements.

**EFRAG Questions (Measurement – cost)**

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*

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<sup>1</sup> This issue will be part of the IASB's rate-regulated activities project.

*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.*

As mentioned in BC16, provisions may not only relate to contracts to deliver goods or provide services but may also comprise obligations which are settled by payment of cash (e.g. in a lawsuit relating to patent infringements). While the measurement of costs directly related to the delivery of goods or the provision of services is consistent with other IFRS Standards such as IAS 2, IAS 16 or IFRS 15, questions arise on how to apply the proposed amendment to other settlement types. Examples are costs of a legal department to handle a lawsuit or costs for actuarial services necessary to determine termination benefit amounts to be settled. Such costs are directly related to the obligation and are similar in nature to, for example, costs for plant management at manufacturing plants or costs for specialists when providing specific services. On the other hand, if such costs were to be included in measuring the provision, this could lead to inconsistencies with other IFRS Standards. For example, IAS 19 does not require or allow the inclusion of costs that relate directly to the obligation (e.g. costs for using actuarial services to determine benefits) when measuring the defined benefit obligation.

Based on these considerations, we suggest including further guidance, especially for obligations, which do not provide for the delivery of goods or provision of services. Such guidance should also be accompanied by illustrative examples embedded in the standard text or in the implementation guidance.

*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.*

We do not foresee significant complexity or costly processes for obligations settled by the delivery of goods or the provision of services, since for these types of settlement cost allocation represents a routine task for most entities. However, this is not the case in situations where other settlement types are involved, e.g. allocation of costs of the legal department (please refer to our answer above). Currently, many entities do not have a system in place for allocating such costs to specific projects or cases, and they would need to introduce a new process. The introduction and the ongoing operation of such systems would lead to additional costs for the entity.

### **EFrag Questions (Measurement – discount rate)**

*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.*

We agree with the proposal to use a risk-free rate also in those cases described, because using other rates prescribed by the applicable regulation would lead to a lack of comparability.

With respect to the disclosure requirements, we understand the need to disclose the interest rates used in measuring the provision. The main reason for our concern is that the relevance of such information may be limited as (a) comparability appears sufficiently supported by the disclosure of the

rate(s) and (b) there is a certain danger that boilerplate language will be used for these disclosures. In addition – considering the IASB’s disclosure initiative – any additional disclosures should only be required if the benefits exceed the costs. As an alternative, we suggest considering a requirement to disclose the approach used to determine the interest rate only in those cases, where the interest rate applied reflects risks concerning the amount or timing of the expenditure required to settle the obligation.

*3.2 Do you consider that the IASB should specify whether an entity **should include or exclude inflation expectations** when estimating the future expenditure required to settle its present obligation and then discounting this amount (see paragraph 52)? If so, please explain how the IASB could address the issue.*

The amount recognized as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. If a settlement is made in a future period, the best estimate also needs to include, among other assumptions, inflation expectations if the amount is discounted using a nominal discount rate.

We understand and support the proposal in the comment letter that the IASB needs to address the issue because of the otherwise incorrect presentation of interest expense in accordance with IFRS 18. This could be done by requiring the use of a nominal interest rate.

*3.3 Would you expect that in practice, differences between how **provisions acquired in a business combination** would be accounted for at the day of acquisition and subsequently would result in day-2 losses being reporting in profit or loss (see paragraph 49(b) above)? If so, how would you recommend the issue to be solved?*

From a conceptual perspective such a day-2 loss appears obvious. In practice, we have not observed this to be a significant issue in most cases, since the range of possible estimates includes both, the best estimate amount and fair value. However, there could be situations where the day-2 loss is significant. One possible solution is to provide for an exception from fair value accounting for provisions in IFRS 3.

### **EFrag Questions (Transition)**

*4.1 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.*

No, we think the simplified retrospective approach should be reasonably applicable.

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

We did not identify any specific factors.

**EFrag Questions (SWPA)**

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.

Yes, we believe disclosing the discount rate provides sufficient information.