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DES NORMES COMPTABLES

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Exposure Draft Provisions - Targeted Improvements

Dear Chair, *Dear Andreas*

The Autorité des Normes Comptables (ANC) welcomes the opportunity offered by the IASB to comment on its Exposure Draft published on 12 November 2024 of targeted improvements on provisions. The ANC wishes first of all to emphasise that, despite their *targeted* scope, these improvements introduce *significant* amendments which contain, in particular with regard to the present obligation recognition criterion, notable changes whose consequences on the role assigned to judgement, on comparability and on the cost/benefit balance should be assessed carefully.

IAS 37 has not been substantially amended since its publication in 1998 and the ANC has observed mixed feedback on the need to propose targeted improvements. For some, application of the standard has proved challenging over time in some circumstances. Several recent submissions to the IFRS-IC, in particular *Negative Low Emission Vehicle Credits* (October 2022), have also highlighted the complexity of applying its recognition requirements, demonstrating the need for more detailed application guidance to reflect changes in obligations and enforcement mechanisms newly encountered in the current economic environment. For others, the complexities of certain fact patterns are not indicative of inherent shortcomings in the standard and the accounting policies developed over time by preparers have made it possible to address these.

On balance, the ANC appreciates the efforts made by the IASB in its attempt to provide more robust foundations to the recognition of provisions. In particular, the proposal to disentangle the present obligation recognition criterion into three conditions of obligation, transfer and past event improves the existing guidance and enables more precise analyses than under the current criteria (paragraphs 1-2). Nevertheless, these proposals require several key clarifications, without which the ANC considers that the new requirements would not work as intended and would lead to detrimental diversity in practice.

Present obligation recognition criterion

Firstly, the ANC notes that a form of economic compulsion is applied in the proposals to legal obligations, so as to determine whether an entity has no practical ability to avoid discharging an obligation. Applying the "no practical ability to avoid" criterion, as provided for in the 2018 Conceptual Framework, may create confusion, particularly if it were to lead to the conclusion that a legal obligation might not exist on the grounds that its economic consequences would be minimal. In its Basis for Conclusions on the Conceptual Framework, the IASB had considered developing guidance to apply the "no practical ability to avoid" criterion, if necessary, as it develops Standards. To address this risk of confusion, the ANC considers that such guidance is needed to apply the proposals to legal obligations (paragraph 5). The ANC also notes that the notion of economic compulsion exists not only for those legal obligations which cannot be enforced in court, but also for constructive obligations, which should be further clarified (paragraph 6).

Also, while the proposals in the Exposure Draft provide a satisfactory framework to analyse many existing mechanisms, the ANC recommends that the IASB clarify the treatment of certain mechanisms where an obligation arises not only from an entity's actions, but also from those of other players in the sector (paragraphs 13-15), which are not specifically addressed in the amendments. Such mechanisms are becoming increasingly common in a variety of sectors and include in particular the Carbon Offsetting and Reduction Scheme for International Aviation (CORSA) in the global airline industry, the Single Resolution Fund (SRF) in the European banking industry, or several mechanisms in the insurance or pharmaceutical industries in France.

Lastly, the ANC understands the merits of the IASB's plan to integrate levies into the IASB provisions model ("the Model"). However, it is essential that this objective be accompanied by robust application guidance included in the body of the standard, making it possible to identify clearly the "actions" and "thresholds" to be taken into account, and to avoid tedious discussions that could lead to detrimental diversity in practice within a single jurisdiction. This Comment Letter details, on the basis of one of the ten French levies studied by the ANC as part of its work, the four key application difficulties on which clarification is essential for the correct application of the Model (paragraphs 16-19 and Appendix B).

The ANC recommends that the application guidance to be developed in response be tested on a wide range of levies and other non-contractual mechanisms to ensure that the proposed clarifications work without unintended consequences.

Measurement

The ANC is generally supportive of the clarifications provided by the Exposure Draft on the expenditures required to settle an obligation, but considers that these proposals should be better aligned with the existing requirements in IAS 37, which allow a provision to be measured either on the basis of a fulfilment value, or on the basis of a transfer value (paragraphs 25-26). Also, the application of the proposals in the Exposure Draft to certain types of obligations, such as those arising from litigation, should be further clarified, in particular for expenditures such as lawyers' fees, or the share of the costs of an in-house legal department (paragraphs 27-28).

The ANC does not object to the proposals in the Exposure Draft clarifying that a discount rate excludes the non-performance risk, i.e., the risk that an entity will not settle its obligation. The ANC also believes that the clarifications provided in the Basis for Conclusions regarding acceptable approaches for determining a discount rate are important and encourages the IASB to retain these in the final version of the amendments (paragraphs 29-31).

Lastly, the ANC generally supports the proposals in the Exposure Draft regarding transition (paragraphs 32-35) and amendments to the Implementation Guidance (paragraphs 39-58) and makes a few suggestions for improvements on these subjects.

Should you wish to discuss our comments further, please do not hesitate to contact us.

Yours sincerely,



Robert Ophèle
ANC Chair

**Exposure Draft Provisions - Targeted Improvements
ANC Comment Letter - Appendix A**

Appendix A is structured as follows:

- . Question 1 - Present obligation recognition criterion (paragraphs 1-24);
- . Question 2 - Measurement - Expenditure required to settle an obligation (paragraphs 25-28);
- . Question 3 - Discount rates (paragraphs 29-31);
- . Question 4 - Transition requirements and effective date (paragraphs 32-37);
- . Question 5 - Disclosure requirements for subsidiaries without public accountability (paragraph 38);
- . Question 6 - Guidance on implementing IAS 37 (paragraphs 39-58);
- . Question 7 - Other comments (paragraphs 59-63).

Question 1 - Present obligation recognition criterion

The IASB proposes: (a) 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); (b) 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)); (c) to amend the requirements for applying that criterion (paragraphs 14A-16 and 72-81); and (d) 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?

1. The ANC supports the IASB's main objective of aligning the requirements of IAS 37 with the definition of a liability provided by the Conceptual Framework revised in 2018.
2. The proposal to disentangle the present obligation recognition criterion into three conditions of obligation, transfer and past event (draft paragraph 14A) is considered useful, as it provides an analytical framework that makes it easier to distinguish conditions that might previously have been confused. Nevertheless, these proposals require several key clarifications as discussed hereafter, without which the ANC considers that the new requirements would not work as intended and would lead to detrimental diversity in practice.

Obligation condition

3. The proposal to base the obligation condition on a notion of responsibility (draft paragraph 14B) embedded in three cumulative sub-conditions (binding mechanism, beneficiary party and absence of practical ability to avoid discharging a responsibility) is considered relevant to address a wide range of situations.
4. Draft paragraph 14F, which specifies the circumstances in which an entity has no practical ability to avoid discharging a responsibility, under both a legal obligation and a constructive obligation, has been subject to particular scrutiny by the ANC. For a legal obligation, draft paragraph 14F(a) states that if the other party has a legal right to act against the entity if the entity fails to discharge the responsibility and, as a result of that right, the economic consequences for the entity of not discharging the responsibility are expected to be "significantly worse" than the costs of discharging it, the entity has no practical ability to avoid discharging a responsibility.
5. In examining draft paragraph 14F, the ANC observed that the Exposure Draft's proposals apply a form of economic compulsion when an entity is required to assess whether it has no practical ability to avoid discharging a responsibility. Draft paragraph 14F(a) refers to the comparison between discharging the responsibility, and the economic consequences, of not discharging the responsibility. This comparison derives from paragraph 4.34 of the Conceptual Framework and is in line with recent IFRS-IC decisions, in particular *Negative low-emission vehicle credits* (October 2022) in which, rather than having the law enforced through a court decision, the government is able to influence an economic behaviour by imposing economic sanctions that might leave an entity with no realistic alternative, but to comply. However, in the more frequent application cases where conventional legal or court enforcement mechanisms apply, the way the economic compulsion rationale should be applied is unclear. For example, should an entity that would incur a penalty of CU100 for a breach of law resulting in an economic benefit of CU200 conclude that no obligation exists in consideration of economic compulsion? When revising the Conceptual Framework in 2018, the IASB noted, while commenting on the interpretation of the "no practical ability to avoid" criterion¹, that it would, if necessary, develop guidance on applying that criterion to particular cases as it develops Standards. The ANC considers that such guidance is needed in the specific case of legal obligations and recommends clarifying how the comparison should be applied, including when reputational risk rather than a penalty is at stake.
6. The ANC also understands that the notion of economic compulsion is not specific to legal obligations, as it may also exist for constructive obligations, even though it is not explicitly mentioned in draft paragraph 14F(b). However, the definition of a constructive obligation was left unchanged by the Exposure Draft and the ANC recommends aligning the definitions of legal and constructive obligations with this important clarification, or providing additional clarifications in the Basis for Conclusions.

¹ Conceptual Framework, Basis for Conclusions, paragraph BC4.54.

Transfer condition

7. The clarification of the condition of transfer of economic resources is useful, as it helps to differentiate between a transfer and an exchange of economic resources, as well as to identify the tipping point between an exchange of economic resources under an executory contract and a transfer of economic resources under an onerous contract (draft paragraph 14L).
8. The ANC notes that draft paragraph 14I refers to the notion of "economic resource" and considers that it would be helpful to specify in the body of the standard that this notion applies to both items recognised as assets and those recognised as expenses, e.g., services, even if such an understanding can be inferred from Examples 7 and 11B.

Past event condition

9. The ANC appreciates the IASB's efforts to clarify the past event condition when the obligation to transfer an economic resource is contingent on an entity having a measure of its activity in a period exceeding a specific threshold (draft paragraph 14P), or on an entity taking two (or more) separate actions (draft paragraph 14Q). Nevertheless, application difficulties were identified on three issues outlined hereafter: the IAS 37 scope (paragraphs 10-12), the impact of third parties' activity and actions (paragraphs 13-15), and applying the IASB provisions model ("the Model") to levies (paragraphs 16-19).

IAS 37 scope

10. Several illustrative examples in the Implementation Guidance refer to an obligation to pay a supplier. This is the case in Example 7, *Staff retraining as a result of changes in the income tax system* and Example 11A, *Refurbishment costs: no legislative requirement*, which address exclusively situations leading to the recognition of trade payables, but also in Example 6, *Legal requirement to fit smoke filters* and Example 11B, *Refurbishment costs: legislative requirement*, which address the interaction between a legislative requirement and a trade payable. These examples seem to imply that, once an entity has received the benefits from the supplier, it has a present obligation in the scope of IAS 37.
11. In addition, if an entity were to apply draft paragraph 14Q to the acquisition of intangible or tangible assets in exchange for contingent consideration in the form of royalty payments, some stakeholders might conclude in some cases that the entity would recognise a liability upon acquisition of the asset for the estimated amount of future royalty payments. Such a treatment would represent a major change to existing practice.
12. While assuming that it is not the IASB's intention to change existing practice regarding contingent consideration payable arising from the acquisition of assets or services suppliers, the ANC is concerned about the potential risk of confusion and recommends that the IASB clarify the scope of IAS 37 in this respect.

Impact of third parties' activity and actions

13. The mechanisms described in draft paragraphs 14P and 14Q are based on the principle that the transfer of economic resources exclusively depends on an entity, either because of its activity or because of its actions. However, the ANC observes the development of a growing number of mechanisms in which the transfer of economic resources depends not only on the activity or actions of an entity, but also on those of other stakeholders, for example players in a certain market or business sector.
14. This observation applies in particular to the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA). Under this scheme, airlines in the sector are assigned a collective annual target for CO₂ emissions that they should not exceed. If the sector's total emissions exceed the collective annual target, each airline is allocated an obligation corresponding to a share of the surplus, proportional to its emissions within the sector. The obligation assigned to each airline may be settled by purchasing and retiring carbon credits. If an airline does not settle its obligation, it incurs a monetary penalty.
15. The CORSIA mechanism illustrates the merit of addressing situations where an entity's activity or actions, combined with those of other stakeholders, may result in the past event condition being met at the entity level. The ANC therefore proposes that the IASB clarifies whether the activity or actions of third parties should be taken into account in the present obligation criterion (draft paragraph 14(a)), or in the criterion related to the probability of transferring an economic resource only (draft paragraph 14(b)). In any case, the ANC recommends clarifying this application issue.

Applying the Model to levies

16. As an introductory comment, the ANC considers that it would be important to clarify, in the definition of the transfer condition (paragraph 14A(b)), that a levy does not give rise to an exchange of resources, in order to distinguish levies from arrangements in which an outflow of resources arises in return for a right, for example a licence to operate.
17. The ANC further confirms that IFRIC 21 had been challenged within its jurisdiction because of the conflict between the timing of the recognition of certain levies and stakeholders' perception of the underlying economic reality.
18. Among all application cases of the Model, levies appear to be in a category of their own, as evidenced by the tests carried out by the ANC to apply it to the ten main levies enforceable in its jurisdiction. The objective of integrating levies into the Model is a challenge, but it may be achievable, subject to clarification of some application issues summarised in paragraph 19 hereafter, and described in detail in Appendix B. Addressing these application issues in the body of the standard through robust guidance highlighting the underlying rationale will help frame judgement, limit subjectivity and avoid heterogeneity of practices. This guidance should be tested on a wide range of levies applicable in various jurisdictions, as well as on other forms of non-contractual mechanisms other than levies, in order to ensure that the clarifications intended to improve the integration of levies into the Model do not cause unintended side effects. Should however this process of refining the Model on a principle-based basis prove unsatisfactory, the development of specific rule-based requirements for levies could be considered as a last resort.
19. In applying the Model to these selected levies, the ANC identified four main application difficulties: (a) Converting a levy's features into "actions" and "thresholds"; (b) Assessing whether two features are separate; (c) Identifying the sequence of actions; and (d) Differentiating between scope and measurement thresholds. Appendix B describes these four application difficulties and applies them to one of the levies examined as part of the ANC's work, which is particularly emblematic of the issues encountered, the Corporate Property Contribution (CFE, *Cotisation Foncière des Entreprises*). The ANC is of course at the IASB's disposal for the analyses carried out on all the other levies tested as part of this project and would be pleased to share them.

Uncertainty about whether the present obligation recognition criterion is met

20. Paragraphs 15-16 of IAS 37 address cases where there is uncertainty about whether the present obligation recognition criterion is met. In the current version of IAS 37, such cases are described as "rare", and this drafting was retained in the Exposure Draft.
21. The ANC notes that Example 1, *Warranties* and Example 10, *A court case* refer to paragraphs 15-16 when analysing the past event condition. Such references are relevant. However, it seems difficult to assert, in view of the situations dealt with, that a warranty or a court case qualify as "rare" cases. The ANC therefore recommends replacing the term "in rare cases" in paragraphs 15-16 with "in certain cases", or alternatively reviewing the drafting of the examples.
22. Moreover, far from being "rare" cases, the fact patterns proposed in Examples 1 and 10 illustrate that any action taken by an entity in the ordinary course of its operations potentially contains the seeds of an obligation. This issue had been considered by the IASB in 2007 when examining the example of an entity that sells hamburgers, some of which, potentially unfit for consumption, could give rise to compensation for contaminated consumers. Among the questions raised by this example was whether an entity should assess whether each sale contains the potential for future compensation. The ANC understands that the IASB's intention in this Exposure Draft is not to require an entity to permanently scan all of its actions to detect the possible existence of a present obligation. This intention should be clarified in paragraphs 15 and 16, as well as in examples 1 and 10, to avoid the proposals in the Exposure Draft being misapplied and leading to unintended consequences.

Restructuring

23. The ANC is supportive of most of the editorial changes made to paragraphs 72-81 on restructuring and welcomes the IASB's proposal to outline, in draft paragraph 80A, the types of obligation that may be present in a restructuring provision. However, the obligations mentioned include, in draft paragraph 80A(b), "contractual obligations to pay penalties for cancelling executory supply contracts the entity entered into before the end of the reporting period". The ANC notes that in its September 2019 agenda decision on compensation for delays or cancellations in the airline industry, the IFRS-IC concluded that such penalties qualify as variable consideration to be accounted for applying paragraphs 50-59 of IFRS 15, and not applying IAS 37. The ANC recommends that the consistency between draft paragraph 80A(b) and the September 2019 IFRS-IC agenda decision, as well as the consequences on Example 5B, *Closure of a division: communication/implementation before end of the reporting period* be re-examined, for example by replacing "supply contracts" with "contracts with suppliers" in order to avoid any risk of confusion with "contracts with customers".
24. Besides, the ANC regrets that the IASB has not taken the opportunity presented by these draft targeted amendments to improve the relationship between IAS 37 and IAS 19 on the issue of termination benefits. Paragraphs 61-62 of this Comment Letter further comment on this issue.

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?

25. Draft paragraph 40A defines the costs to be included in the measurement of a provision as a settlement cost, i.e., on the one hand, the incremental costs of settling the obligation and, on the other hand, an allocation of other costs that relate directly to the settling obligations of that type.
26. The ANC notes that paragraph 37 of IAS 37, which is not targeted by the proposed amendments, may be read as referring to measurement objectives for a provision: either a fulfilment value, in line with draft paragraph 40A, or a transfer value, i.e., the amount that an entity would pay to transfer the obligation to a third party. The ANC therefore invites the IASB to clarify the relationship between paragraph 37 and draft paragraph 40A, or to restrict the scope of draft paragraph 40A to the measurement of onerous contracts. However, this second alternative would seem to depart from the original intention of the Exposure Draft proposal.
27. The ANC observes that the proposed requirements in draft paragraph 40A may be difficult to apply to certain situations, particularly to litigation and lawyers' fees, which may be analysed as either a transfer of resources - in which case such costs *could* be recognised as a provision - or an exchange of an economic resource - in which case such costs would *never* be recognised as a provision. Also, some stakeholders may consider that providing for internal costs might be equivalent to recognising costs to operate in the future, which is precluded by current paragraph 18 -of IAS 37, whose principles remain valid. It would therefore be helpful to clarify this matter, which is extremely prevalent in practice by adding specific application guidance or by considering developing an illustrative example on the measurement of the expenditures required to settle an obligation for a litigation (lawyers' fees, share of the costs of an in-house legal department, etc.).
28. The ANC also observed that the proposed requirements in draft paragraph 40A may be difficult to apply to obligations to be settled using carbon credits generated internally as part of a production activity, such as in Example 14 where an entity may settle an obligation at no incremental cost by surrendering positive credits generated from manufacturing clean vehicles and selling them at a profit. In such cases, it may be difficult to identify which types of expenditures should be considered in the measurement of the carbon credit and as such, be regarded as directly related to the settlement of the obligation. The ANC suggests that additional guidance be provided on this issue.

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?

29. The ANC does not object to the IASB's proposal that a discount rate should be a risk-free rate that reflects the time value of money, and that the non-performance risk, i.e., the risk that the entity will not settle the obligation, should be excluded. The ANC also supports the IASB's proposal to require disclosing the discount rate and the general approach used to determine it.
30. The clarifications provided by paragraph BC68 of the Basis for Conclusions on the Exposure Draft on the acceptable methods for reflecting risks specific to a liability, and in particular the fact that an increase in risk can be reflected either by an increase in the cash flow or by a decrease in the discount rate, are helpful. The ANC considers that these clarifications should be incorporated into the standard.
31. The ANC also considers that the clarifications provided by paragraph BC82 of the Basis for Conclusions, for determining an appropriate risk-free rate, are helpful. The guidance provided on the reference to an observable market proxy for a risk-free rate adjusted, where appropriate, for the effects of duration or liquidity are useful clarifications that should be retained in the Basis for Conclusions of the final standard.

Question 4 - Transition requirements and effective date

Transition requirements

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?*

32. The ANC is in favour of proposing a general principle of retrospective application together with two simplifying exceptions relating, firstly, to the costs included in the measure of a provision (draft paragraph 94D) and, secondly, to the discount rate (draft paragraph 94E).
33. The ANC understands that draft paragraph 94E has been drafted in such a way as to allow for several possible approaches. Further, while a simple proportional allocation of the transition adjustment between the asset and retained earnings, based solely on the proportion of the remaining and past useful life of the asset compared with its entire useful life, may be appropriate in some circumstances, other considerations such as the impact of the unwinding of the discount may also be relevant. Accordingly, the ANC suggests that further development should be included in the Basis for Conclusions on the Exposure Draft, to facilitate the understanding and application of draft paragraph 94E.
34. The ANC notes that the two proposed simplification exceptions, relating to costs included in the measure of a provision (draft paragraph 94D) and to the discount rate (draft paragraph 94E), allocate the impact of the change in accounting method to equity at two different dates: at the beginning of the period of initial application, without restating comparative information, for costs included in the measure of a provision (paragraph 94D); and at the beginning of the first comparative period presented for the discount rate (paragraph 94E).
35. The ANC understands that the proposal of two different dates for the two options is intended to be consistent with both the general principle of retrospective application, mitigated by the concern to preserve an acceptable cost/benefit balance, and the approaches previously adopted by the IASB when amending IAS 37 in 2020 to specify the costs an entity takes into account in assessing whether a contract is onerous, as well as the exception set out in paragraph D21 of IFRS 1. However, a provision that would be affected by the requirements of *both* draft paragraphs 94D and 94E would be adjusted over two different periods, which may impair the overall understandability of the financial statements. The ANC therefore invites the IASB to reconsider the proposal of using several application dates.

Effective date

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?*

36. As highlighted in this Comment Letter, the application of the 2018 Conceptual Framework definition of a liability to IAS 37, the disentanglement of the present obligation criterion and the withdrawal of IFRIC 21 as a result of applying the amendments in the Exposure Draft to levies represent significant changes. Such changes rely on new approaches, such as the three-condition analysis of the present obligation criterion, and even new concepts, such as the present obligation accumulating over time. All these elements represent notable changes to a standard whose requirements have changed relatively little since it was issued in 1998. Furthermore, provisions are one of the most common issues in accounting and the proposals in the Exposure Draft will impact a wide range of stakeholders.
37. Those stakeholders will need to become familiar with these new requirements, to review the existing mechanisms, re-document their analyses and in some cases, revise their accounting for provisions. The magnitude of such tasks should not be underestimated when assessing the time needed to prepare for the amendments proposed in the Exposure Draft.

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?

38. The ANC is not commenting this issue.

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: (a) to expand the decision tree in Section B; (b) to update the analysis in the illustrative examples in Section C; and (c) 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?

Decision tree

39. The IASB proposes a new three-part decision tree summarising the process of applying the three criteria for recognising a provision set out in draft paragraphs 14-26: Present obligation recognition criterion (part B1); Additional decision needed if it is unclear whether the present obligation recognition criterion is met (part B2); and Probable transfer and reliable estimate recognition criteria (part B3).
40. The ANC is supportive of the proposed revision of the new three-part tree and suggests merging the three sections together into a single decision tree to make the whole analysis process easier to understand, without compromising the diagram's overall legibility.

Illustrative examples

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

41. The fact pattern proposed in Example 5B provides that the board of an entity decided to close a division making a particular product. Some customers will have a contractual right to receive contract termination penalties.
42. The ANC recommends that the reference to customers having a contractual right to receive termination penalties, be reconsidered in relation to the re-examination suggested in paragraph 23 of this Comment Letter, to replace "supply contracts" with "contracts with suppliers" in order to avoid any risk of confusion with "contracts with customers".

Example 6 - Legal requirement to fit smoke filters

43. Draft paragraph 14E carries forward the requirements of the current paragraph 20 of IAS 37 to clarify that an obligation is always owed to another party, whether identified or society at large. Illustrative examples 2A, 2B, 12, 13A, 13B, 13C and 14 refer to government "which acts on behalf of society at large". However, Example 6 refers only to "factory workers", whereas the damage is potentially broader and could also affect local residents or even society at large. The ANC therefore recommends that the IASB either align the drafting of Example 6 with that of the other examples, or explain why this example refers only to "factory workers".
44. More broadly, in relation to the illustrative examples that refer to government "which acts on behalf of society at large", the ANC recommends that the IASB clarify if a government is part of a mechanism in place that imposes a responsibility on the entity in the meaning of draft paragraph 14B(a), or qualifies as another party within the meaning of draft paragraph 14B(b).

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

45. In Example 7, a government introduced a number of changes to the income tax system, as a result of which an entity in the financial services sector will need to retrain a large proportion of its administrative and sales staff.
46. In the context of the proposals in the Exposure Draft, where the present obligation criterion is disentangled into three conditions of obligation, transfer and past event, the drafting "will need to retrain", which is a legacy from the former drafting of the illustrative example, now seems insufficiently precise, as it leaves some doubt as to whether the training is carried out by the entity in order to comply with the regulations, or to derive a benefit from the training. In the analysis of the obligation condition, the first two sentences² contain elements of context that would be more useful if added to the fact pattern.

² "Financial services regulation imposes a responsibility on the entity to provide its services to a specified standard (paragraph 14B(a)). The entity will carry out staff retraining to ensure it continues to provide its services to the specified standard in the future."

47. More precisely, while being in agreement with the overall conclusion that no provision is needed, the ANC considers that the discussion on the obligation condition might create a confusion as to whether the entity has a regulatory compliance obligation, versus whether the entity has only a need to retrain its staff for its sole business purpose. If in the former case, the analysis should be revised to consider the following: (a) the entity might have a responsibility to its customers and/or to the government, i.e. the requirement in draft paragraph 14B(b) might be met; (b) if the entity could have to pay a penalty or could be forced to exit the market, the obligation could be enforceable, therefore the requirement in draft paragraph 14B(c) might be met; and (c) the past-event condition will not be met until the entity has begun to operate in a non-compliant manner. The ANC considers that, as currently drafted, the Example 7 does not fully analyse the regulatory compliance obligation.

Example 11B - Refurbishment costs: legislative requirement

48. In Example 11B, an airline is required by law to overhaul its aircraft once every three years and the entity has not overhauled them for two years. The analysis of the past event condition includes two comments intended to justify that the condition is not met. Firstly, the entity has not yet undertaken the action giving rise to the obligation to overhaul the aircraft, i.e., to operate an aircraft that has not been overhauled for more than three years. Secondly, the entity has not yet obtained the economic benefits associated with aircraft overhaul services.
49. The ANC recommends that the fact pattern in Example 11B be supplemented by specifying the consequences for the entity of not overhauling aircraft.
50. As indicated in paragraphs 10-12 of this Comment Letter, the reference to an obligation to pay a supplier as soon as an entity has received its services, seems to suggest that the obligation to pay the supplier would be in the scope of IAS 37, which could create a risk of confusion. Consistently, it should be specified, in the analysis of the past event condition in Example 11B, that obtaining the economic benefits associated with aircraft overhaul services is not in the scope of IAS 37.

Example 13A - A levy on revenue

51. The ANC notes that draft paragraph 14F(a)(ii) refers to "significantly worse" economic consequences, whereas illustrative examples 13A, but also 13B and 14 refer to "significantly more adverse" economic consequences, as in paragraph 4.34 of the Conceptual Framework. The ANC recommends that the terminology used in the proposed improvements and illustrative examples be harmonised in order to avoid any confusion.

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

52. The fact pattern in Example 13B provides that any entity that operates as a bank on the last day of its annual reporting period falls within the scope of the levy. The analysis of the obligation condition indicates that the entity has a liability if it undertakes two distinct actions: firstly, operating in the current annual reporting period and secondly, operating as a bank on the last day of that period.
53. The fact pattern in Example 13B also states that the amount of the levy is proportional to the length of the reporting period. ANC stakeholders debated whether this feature of the levy provides the basis for the first action (operate during the current financial year) identified in the obligation condition analysis. If it does, it would be helpful to make it more explicit. Also, it could be useful to explain why draft paragraph 14R is not relevant here, to the extent that ceasing one of the activities of an entity should not be confused with liquidating the entity or definitively ceasing to trade.
54. Although the appropriate accounting treatment of the levy in an interim period may be inferred from the analysis in the example, the ANC recommends that it be more explicitly indicated, as set out in paragraph BC39(d) of the Basis for Conclusions on the Exposure Draft. The same comment applies to example 13C.

Example 13C - A property tax

55. The fact pattern in Example 13C considers an annual property tax on land and buildings held for business use. On 31 December 20X5, an entity owns and holds for business use land and buildings acquired in 20X0. The elements of analysis considered by the entity's management specify that although buying the land and buildings at an earlier date affects the amount of tax payable, it is not an action required for tax to be payable. The analysis further observes that the tax is payable regardless of when land and buildings were bought.

56. As pointed out in paragraphs 16-19 and Appendix B of this Comment Letter, the correct conversion of “legal obligation triggers” and “tax base” of a levy into “actions” and “thresholds” is essential to the correct application of the Model. The ANC therefore recommends that a more precise explanation be provided in this example as to why the acquisition or use of land and buildings held for business use at an earlier date do not qualify as “actions”.

Example 15 - Climate-related commitments

57. The fact pattern considered in Example 15 describes an entity that publicly states in 20X0 its commitments to gradually reduce its annual greenhouse gas emissions, and to offset its remaining annual emissions in 20X9 and in later years by buying carbon credits and retiring them from the carbon market.
58. The analysis of the transfer condition identifies two actions, i.e., “Obligation to reduce emissions” and “Obligation to offset remaining emissions”. However, the analysis of the past event condition comments only on the “Obligation to offset remaining emissions” without commenting on the “Obligation to reduce emissions”. For the sake of completeness, the ANC recommends that a consistent approach be applied to all elements of the rationale provided.

Question 7 - Other comments

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

59. In this question, the ANC wishes to comment on two interactions between the proposals in the Exposure Draft and IFRS 3 (paragraph 60) and IAS 19 (paragraphs 61-62) which, although not within the scope of the project, are worth considering. The ANC also wishes to raise an issue related to the position of a comment period within the financial year (paragraph 63).

Interaction with IFRS 3

60. For each business combination, a provision is measured, in accordance with IFRS 3, at the acquisition-date fair value calculated using a discount rate including non-performance risk, as illustrated by Example 11, *Decommissioning liability* in IFRS 13. However, the discount rate applied subsequently would, applying the proposed amendments, exclude non-performance risk. To avoid this difference resulting in the unintended effect of a "Day-2 loss" being recognised after the acquisition date, either immediately or over the remaining useful life of the related asset (if any), depending upon the nature of the obligation and the counterpart of the provision, the ANC recommends introducing an exception to IFRS 3, requiring discounted provisions to be measured in accordance with the requirements of the Exposure Draft.

Interaction with IAS 19

61. The ANC recommends that the IASB consider the possibility of harmonising the requirements in IAS 19 and IAS 37 on the recognition of termination benefits under a single principle. The differences between the two standards in terms of recognition date for a liability are a recurring source of difficulties, while not resulting in relevant information for users. For example, depending on fact patterns, a restructuring plan exclusively consisting of termination benefits could be recognised at different dates, depending on whether it is analysed under IAS 19 or IAS 37.
62. Also, paragraph 165 of IAS 19 contains a requirement on the recognition date of termination benefits, as well as a cross-reference to the requirements of IAS 37 on restructuring, IAS 37 does not contain any cross-reference to IAS 19 that would enable readers to liaise with the requirements of paragraph 165 of IAS 19. The ANC therefore suggests that the clarifications provided by draft paragraph 80A under the Exposure Draft, be supplemented by a cross-reference to paragraph 165 of IAS 19.

Position of a comment period within the financial year

63. In recent years, the IASB decided to open up comment periods including, for a large number of stakeholders, the periods for preparing and closing annual financial statements. The ANC understands that this decision is driven by the IASB's own agenda constraints. However, the ANC wishes to emphasise that it is particularly difficult to mobilise stakeholders during this busy period and recommends that in future the IASB should avoid, as far as possible, opening up comment periods encompassing the periods for preparing and closing annual financial statements. If it were impossible to avoid a comment period running concurrently with the period for preparing and closing annual financial statements, the IASB could alternatively consider extending the comment period beyond 120 days.

**Exposure Draft Provisions - Targeted Improvements
ANC Comment Letter - Appendix B**

As part of its review of the Exposure Draft, the ANC applied the IASB provisions model (“the Model”) to the ten main levies enforceable in its jurisdiction and identified four main application difficulties: (a) Converting a levy’s features into “actions” and “thresholds”; (b) Assessing whether two features are separate; (c) Identifying the sequence of actions; and (d) Differentiating between scope and measurement thresholds. The analysis hereafter describes these four application difficulties and applies them to one of the levies examined as part of the ANC’s work, which is particularly emblematic of the issues encountered, the Corporate Property Contribution (CFE, *Cotisation Foncière des Entreprises*). As far as they are considered as relevant for accounting analysis purposes, the key features of this levy are outlined hereafter.

Fact pattern. The CFE is defined by a “legal obligation trigger”, i.e., an entity is running an activity on 01/01/N, it being specified that if the entity ceases to run the activity at some point in N, in an event other than a sale or transfer of activity, the amount of the levy will be adjusted on a *pro rata temporis* basis. The CFE “tax base” corresponds to the assets subject to property tax with a non-zero rental value as of 31/12/N-2, that the entity has owned or leased in N-2. The levy due by the entity on 01/01/N is calculated by applying rates voted towards the end of N-1 under the N Finance Act to the rental value of the assets as of 31/12/N-2. A flat-rate levy of insignificant amount is required from all taxpayers.

Liability recognition under IFRIC 21. Currently, the consensus prevailing within the ANC’s jurisdiction recognises the CFE as a progressive accrual over N – or part of N if the entity ceases to run the activity at some point in N.

Liability recognition under the Model

Description of the application issue		Application of the issue to Corporate Property Contribution (CFE, <i>Cotisation Foncière des Entreprises</i>)
<p>#1. Converting a levy’s features into “actions” and “thresholds”</p>	<p>Tax authorities typically define levies on the basis of features consisting of a “legal obligation trigger” and a “tax base”, while the Model’s analytical framework uses the notions of “actions” and “thresholds”. Converting a levy’s “legal obligation trigger” and “tax base” into the Model’s “actions” and “thresholds” requires judgment and may be difficult to apply in practice.</p> <p>Example 13C, <i>A property tax</i> notes that, for a levy’s feature to qualify as an “action”, that feature should be “required for tax to be payable”. In that example, this observation leads to the conclusion that <i>The entity acquired an asset at an earlier date</i> is not an “action”.</p> <p>The observation in Example 13C is a useful starting point but, in itself, is insufficient to understand the IASB’s reasoning. The ANC observed that many stakeholders were uncertain about the IASB’s intention with respect to balance-sheet-based levies. Those stakeholders expressed concerns that the proposals in the Exposure Draft would require the anticipated accrual for several financial periods in advance, or even over an indefinite period, i.e., how far into the future the assessment should be performed. The persistence of this observation convinced the ANC that this issue deserved to be clarified in the body of the standard.</p> <p>In addition, while identifying “actions” raises questions for balance-sheet-based levies, similar concerns may arise for flows-based levies, especially where a “tax base” consists of local GAAP revenue with a different recognition pattern under IFRS. In other words, should the local GAAP revenue recognition pattern be considered as an “action” for levies recognition purposes, even if different principles apply under IFRS for revenue recognition purposes?</p> <p>The ANC suggests that the reasons for a levy’s feature to qualify as an “action” be developed further, for example by specifying that an action needs to have a direct impact on the amount to be paid by the entity.</p>	<p>Under the considered fact pattern, it is possible to identify two relevant features in the CFE’s definition:</p> <p>Feature 1. <i>An entity has owned or leased assets subject to property tax in N-2 with a non-zero rental value as of 31/12/N-2; and</i></p> <p>Feature 2. <i>An entity is running an activity in N.</i></p> <p>Feature 2 combines both the fact that the entity is running an activity on 01/01/N, and that if the entity ceases to run the activity at some point in N, the amount of the levy will be adjusted on a <i>pro rata temporis</i> basis.</p> <p>Example 13C hints that to qualify as an “action”, a feature should be “required for tax to be payable”.</p> <p>Applying the Example 13C approach, the ANC understands that features such as <i>acquiring assets</i> or <i>entering into leases</i> are not actions that are “required for tax to be payable” under tax law and as such, should not be considered in the analysis.</p>

Description of the application issue		Application of the issue to Corporate Property Contribution (CFE, <i>Cotisation Foncière des Entreprises</i>)
<p>#2 - Assessing whether two features are separate</p>	<p>Application Issue 1 illustrates that the analysis of a levy's features may potentially result in the identification of one or several "actions". It is therefore necessary to determine whether these features are separate, or whether these are part of one single "action". Depending on the conclusion, the levy recognition pattern may be different.</p> <p>The difficulty of assessing whether two actions are separate may also be increased by the fact that the levy's features relate to different financial periods. Features relating to different periods also raise the question of whether an annual levy may accumulate over more than one financial period.</p> <p>In order to clarify this application issue, the ANC suggests that guidance be provided on the criteria to be considered to exercise judgement, for example by specifying that two features may qualify as separate "actions" if there is no direct causal relationship between those two features.</p>	<p>The ANC considered two possible views.</p> <p>Under View 1 (multiple-action approach), features 1 and 2 are separate. Under this view, Feature 1 is identified as a separate action, since the absence of rental value as of 31/12/N-2 would result in no taxation, other than the flat-rate levy of insignificant amount.</p> <p>Under View 2 (single-action approach), features 1 and 2 are merged into one single action: <i>An entity running an activity in N had assets with a non-zero rental value as of 31/12/N-2.</i></p> <p>The ANC observes that it is particularly difficult to assess whether two features qualify as one or two "actions", especially when the two features relate to two different financial periods and, as in the present case, to two balance sheet dates.</p>
<p>#3 - Identifying the sequence of actions</p>	<p>Draft paragraph 14Q provides that, in situations where the transfer of resources depends on two (or more) separate actions by an entity, the past event condition is met when the entity has taken the first action (or any of the actions) and does not have the practical ability to avoid taking the second action (or any of the remaining actions).</p> <p>Draft paragraph 14Q is based upon a sequential reasoning, requiring the identification of an initial action, followed by one (or more) resulting action(s). The correct identification of that sequence is therefore essential, as the identified initial action will be the starting point for the entity's management in assessing whether the entity has no practical ability to avoid taking the second (or any of the remaining) action(s).</p> <p>The ANC suggests that this sequential dimension be further commented on, in particular to identify the initial action and to assess whether the existence of a sequence of several features should be regarded as an indication that these qualify as separate actions.</p>	<p>Features 1 and 2 do not occur simultaneously: 1 comes first, then 2 follows.</p> <p>If the identification of a sequence were to be regarded as an indication that features 1 and 2 are separate, View 1 (multiple-action approach) would be confirmed: Feature 1 would qualify as the initial action and Feature 2 would be the action for which management should assess whether the entity has no practical ability to avoid taking it (paragraph 14Q).</p> <p>If however the existence of a sequence of two or more features were to be regarded as irrelevant, for example under the argument that the feature derived from the "legal obligation trigger" should take precedence over any other identified feature, View 2 (single-action approach) would be confirmed: Feature 2 would be the basis of a single action and Feature 1 would be only one of its components.</p>
<p>#4 - Differentiating between scope and measurement thresholds</p>	<p>Not all apparent thresholds present in a levy's features genuinely qualify as "thresholds" within the meaning of the Model, i.e., about which exercising judgment is necessary.</p> <p>It is therefore necessary to make a distinction between scope thresholds, which are used solely to determine whether an entity is subject to a levy, and measurement thresholds, which are relevant to the analysis of the levy under the Model.</p> <p>The ANC recommends that this particular application issue be addressed in the Model's application guidance, to clarify potential interactions with the identification of "thresholds".</p>	<p>The requirement of a non-zero rental value present in Feature 1 does not seem to qualify as a genuine threshold on which exercising judgment would be necessary under the Model.</p>

Possible conclusions. As a result of the above analysis, several possible conclusions with diverging accounting consequences are considered hereafter. Under View 1 (multiple-action approach), two separate actions are identified. Under View 2 (single-action approach), one single action is identified. Accordingly:

View 1 (multiple-action approach). Two possible conclusions are considered under View 1, depending on the judgment applied by management at the end of N-2 on its capacity to assess the rates that will be voted towards the end of N-1 under the N Finance Act:

View 1.1. At the end of N-2, management considers that it is necessary to wait for the rates voted towards the end of N-1 under the N Finance Act. As a consequence, no provision is recognised on 31/12/N-2. On 31/12/N-1, the entity immediately recognises a provision if: (a) the entity has performed Action 1 and has no practical ability to avoid Action 2 (draft paragraphs 14Q and 14R); and (b) the amount of the obligation can be measured reliably on the basis of the rental value of property subject to property tax in N-2 and the actual rates voted towards the end of N-1 under the N Finance Act (draft paragraph 14(c)).

View 1.2. At the end of N-2, management considers that it is possible to perform a reliable estimate of the rates expected to be voted towards the end of N-1 under the N Finance Act, for example because rates do not change significantly from one period to another. On 31/12/N-2, the entity immediately recognises a provision without waiting until 31/12/N-1, if: (a) the entity has performed Action 1 and has no practical ability to avoid Action 2 (draft paragraphs 14Q and 14R); and (b) the amount of the obligation can be measured reliably on the basis of the rental value of property subject to property tax in N-2 and an estimate of the rates expected to be voted towards the end of N-1 under the N Finance Act (paragraph 14(c)).

View 2 (single-action approach). As the amount of the levy would be adjusted *pro rata temporis* if the activity ceases in N, it is the use of the asset during N rather than on 01/01/N that drives the economic substance of the levy and forms the basis for a past event occurring over time (draft paragraph 14O). Accordingly, the entity progressively recognises a provision over N, as under the current IFRIC 21 recognition pattern.