EFRAG
Financial reporting

Draft Comment Letter

You can submit your comments on EFRAG's draft comment letter by using this form.

Comments should be submitted by 25 February 2025 (EFRAG has requested the IASB to extend the comment period on the ED. Should the IASB agree, EFRAG will similarly extend its comment period on this Draft Comment Letter).

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

[Date, 2025]

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 identifies three areas for targeted improvements with the aim of clarifying current requirements, reducing diversity and changing the timing of recognition of some provisions.

EFRAG considers the proposals which aim to clarify the current requirements on when an entity has a present obligation overall useful. [EFRAG's position on changing the timing of recognition of some provisions to be inserted following input from constituents].

EFRAG supports the proposal to specify that the costs to settle a present obligation comprise the costs that relate directly to that obligation.

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 is a risk-free rate and should not include non-performance risk. Overall, EFRAG agrees with these proposals as

reflecting non-performance risk in the discount rate(s) could have a counterintuitive impact on the resulting measurement.

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

Chair of the EFRAG FRB

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

Question 1 – Criteria on when an obligation is present

Notes to constituents – Summary of the 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 implies 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 example, 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 a 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 result, 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 a measure of its activity in a period exceeds a threshold, a present obligation arises as the entity carries out the activity for which the threshold is related. A provision should thus be recognised for the portion of the total expected obligation before the threshold is met if: (1) it is also probable that the 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.

(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 proposed Guidance on implementing IAS 37 includes examples of when to recognise a levy that requires a transfer of an economic resource only if the entity takes two (or more) separate actions (Examples 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 In the following paragraphs, EFRAG:

(a) first comments on the main changes resulting from the proposed requirements on when an entity has a present obligation (paragraphs 3–8); and

(b) secondly, comments on how the proposed requirements on when an entity has a present obligation are clarified in the ED (paragraphs 9–10).

Comments on the main changes resulting from the proposed requirements for when an entity has a present obligation

3 EFRAG notes that the ED proposes to amend the requirements on when an entity has a present obligation by specifying when the past event condition is met in the following two scenarios:

(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); and

(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 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.

4 The outcomes of these two scenarios are different. If the entity has already acted in a manner that could trigger a transfer of an economic resource when the entity acts or performs in a particular manner in the future, the outcome could depend on whether the future act or performance of the entity is considered as a second (separate) action or a continuation of an activity. As stated in the Basis for Conclusions accompanying the ED, management will have to reach a conclusion on whether an act or performance is a separate action or a continuation of an activity by assessing all the relevant facts of the mechanism.

5 EFRAG acknowledges that there could be arguments both in favour and against the two different proposed specifications (those listed in paragraph 3). The arguments could also be different for the two proposed specifications and could depend on the type of provision.

6 However, although the arguments could be different, they are also interlinked. Both specifications will result in some provisions being recognised earlier than currently and, in some cases, also being built up over a (longer) time period. Accordingly, EFRAG presents below arguments in favour and against the two proposed specifications in a combined manner.

7 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

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

providers tend to prefer information reflecting 'persistent' or 'recurring' earnings[2]. An implication of this could be that the reported earnings are 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 could be argued that it results 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 January 20X2. Similarly, if an entity has to pay an amount if over a two-year period it exceeds 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 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 over a period of time. Recognising the expense related to such a 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 in the next period a levy proportionate to the length of the period in which it has used the asset (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 faithful representation and comparability**. Based on the recognition of a provision for a levy that depends on the entity taking two (or more) separate actions or the entity's activities reaching a threshold, the requirements of IFRIC 21 could result in what could be considered a random recognition of that liability, which

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

does not reflect facts and circumstances. 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, Member States can decide the specific date in a year on which an entity should be operating to be covered by a particular levy (that would otherwise apply to all entities operating within the EU). If that levy is related to economic benefits the entity has received 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 facts and circumstances for entities in different jurisdictions to recognise a liability for that levy at different dates. Furthermore, it would not result in comparable information if entities recognise provisions for the same levy in different periods. Similarly, in the example of an entity exceeding a threshold provided above in paragraph 7(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 IFRS 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. It 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 IFRS 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 IFRS Accounting Standards such as the following.

- IAS 19 *Employee Benefits*. Paragraph 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. Also, the proposals could seem more consistent with other requirements in IAS 19, such as the requirements on defined benefit plans (paragraph 72 of IAS 19).
- IFRS 2 *Share-based Payment*. Paragraph 19 of IFRS 2 states that (despite the fact that 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 payments, paragraph 33B of 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.
- IFRS 3 *Business Combinations*. According to paragraphs 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 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 the following.

- IAS 12 *Income Taxes*. Paragraph 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 (and not recognition) of current and deferred tax assets and liabilities.)
- IAS 19. Paragraph 20 of IAS 19 states that profit-sharing plans create a constructive obligation as employees render services that increase 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*. Paragraph B7 of IAS 34 states that variable lease payments based on sales can be an example of a legal or constructive obligation that is recognised as a liability. If 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. Also, the proposals could seem more consistent with the requirements in IAS 34 on income tax expenses that should be recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year (paragraph 30(c) of IAS 34).

8 Against the proposals included in the ED, EFRAG notes that the proposals could be argued to 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**. The IASB's Conceptual Framework does not allow the recognition in the statement of financial position of items that do not meet the definition of an asset, a liability or equity (paragraph 5.5 of the Conceptual Framework). The application of the concepts in the Conceptual Framework leads to 'matching' when it arises from the recognition of changes in

assets and liabilities. However, 'matching' revenues received from customers with levies paid to the government are irrelevant because: 1) customers and the government are unrelated third parties and 2) levies are not reciprocal transactions. Because levies are not reciprocal transactions, trying to achieve 'consistency' with accounting for reciprocal transactions is also irrelevant. Such transactions include employee benefits offered in exchange for employee services in IAS 19 or IFRS 2 and regulatory liabilities incurred in a rate-regulated environment as part of the total allowed compensation of the entity in return for providing regulated services.

Unlike reciprocal transactions, 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 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, including actions that 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 7(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 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 and 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 that it does not to result in the best faithful representation.

(ii) **Recognition of liabilities that do not exist**. Applying the proposals will result in recognising liabilities that do not exist, as in examples 13A and 13B of the proposed amendments to *Guidance on implementing IAS 37*. For non-reciprocal transactions, liabilities should only be recognised when they are due based on the legal triggering event for that liability and when there is no other meaningful alternative.

(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 the following factors.

(i) **When an entity does not have a practical ability to avoid taking specific future actions**. For example, the proposed new paragraph 14R states that 'A decision to prepare an entity's financial statements on a going concern basis implies that the entity has no practical ability to avoid taking an action it could avoid only by liquidating the entity or by ceasing to trade.' However, the application of such a principle in consolidated financial statements is unclear.

(ii) **What affects recognition and what affects measurement**. As noted above, the ED proposes a new requirement related to when an entity has an obligation to transfer an economic resource only if it takes two (or more) separate actions. According to the ED, 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), and the requirement to transfer an economic resource is a consequence of taking both (or all) these actions. Different views could exist on when a requirement to transfer an economic resource is a consequence of taking both (or all) these actions. For example, an entity could be required to pay a levy next year if it is operating next year based on the revenue it is generating in the current period. Different views could exist on whether the fact that an entity is generating revenue in this period results in a requirement to transfer an economic resource next year if the entity is operating next year. Different views could exist, for example, when all entities operating next year will have

to pay an amount, but for those not operating in this period the amount would be fixed, whereas for those operating in the current period the amount would be based on the revenue generated in the current period.

(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 to transfer an economic resource only if it takes two (or more) separate actions**. As noted in paragraph 3, the ED amends the requirements on when the past event condition is met by specifying when the condition is met for two different scenarios:

- when an entity has an obligation to transfer an economic resource only if it takes two (or more) separate actions; and
- 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 threshold.

As the past event condition may be met at different points in time depending on which of the two scenarios is considered to apply to a given situation, how a given situation is assessed matters.

For example, it could be that an entity would have to pay an amount to the authorities if twice within a year it would emit smoke that is not be sufficiently clean. In this case, should the second emission of unclean smoke be considered as a separate action or a continuation of the entity's activity of emitting unclean smoke? In other words, if an entity expects that it will emit unclean smoke twice within a year but has the practical ability to avoid doing so, should the entity recognise a provision when it emits unclean smoke for the first time? It could be expected that there would be different assessments on this which would reduce comparability between entities.

In some cases, it could also be that an entity has an obligation to transfer an economic resource only if it takes two (or more) separate actions and that the entity together with other entities within the same jurisdiction or industry exceed a certain threshold related to their activity. Also in these cases, entities may have different views on which of the scenarios listed in paragraph 3 they fall under.

(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 to 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. In addition, the proposals could be seen as internally inconsistent: in example 13A, a liability is recognised before the date at which the levy becomes payable because it is considered to relate to two separate actions, i.e. generating revenue in one period and operating in the market on the first day of the following period. In contrast, in example 13C a liability is only recognised at the date at which the levy becomes payable because it is considered to relate to one action only, i.e. owning the building on the due date and holding it for business use on that date. In the latter case, it is not clear why the levy is not considered to relate to another action, i.e. acquiring (or constructing) the building for business use in addition to holding it at the due date. Asset-related levies are equally common as activities-related levies and what could be perceived as opposite outcomes when accounting for these two common types of levies may not improve the understandability of the information.

EFRAG Questions to Constituents

Paragraphs 7 to 8 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 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?

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)?

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

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.

Comments on how the proposed requirements on when an entity has a present obligation are clarified in the ED

9 EFRAG appreciates the fact that the proposed requirements and additional guidance included in the ED on when an entity has a present obligation are helpful.

10 However, EFRAG considers that additional guidance to address the issues mentioned in paragraph 8(c) needs to be included should the IASB move forward with the proposals. EFRAG, for example, notes that Example 13A—*A levy on revenue* in the proposed *Guidance on implementing IAS 37* 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 to IAS 37 (i.e. the IFRS 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 IAS 37 itself.

11 To make the revised IAS 37 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) by considering these separately. 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); and

(b) **move specific requirements to the application guidance** (e.g. how to consider new legislation and restructuring). This suggestion is based on the fact that specific criteria should be met for (1) new legislation (virtually certain to be enacted) and (2)

restructuring (specific requirements to be met before a restructuring provision exists and is recognised).

Question 2 – Costs included in the estimation of the expenditure required to settle a provision

Notes to constituents – summary of proposals in the ED

12 *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 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.*

13 *Currently, 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.*

14 *In May 2020, the IASB issued a narrow-scope amendment to IAS 37 that included a 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 for that assessment 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 property, plant or equipment.*

15 *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.*

16 *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. The ED clarifies the costs that should be included in estimating the future expenditure required to settle an obligation.*

17 *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

18 EFRAG supports the proposal to specify that direct costs (as described in the ED) be included in measuring a provision. The proposal is consistent with the May 2020 amendment to IAS 37 regarding the assessment of an onerous contract. In EFRAG's view, considering different types of costs when assessing whether a contract is onerous and when measuring the onerous contract would not result in the most useful information.

19 EFRAG notes that the ED proposal 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. 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 (e.g., the cost of the internal legal department) related to settling obligation of the given type may be associated with uncertainty and cost.

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

20 EFRAG considers that it would be useful to include additional application guidance and illustrative examples on the type of costs an entity should include when measuring a provision.

21 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 and 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

22 *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.*

23 *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.*

24 *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, AA-rated corporate bonds) on that type of investment.*

25 *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.*

26 *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)

27 *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.*

28 *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 another entity reports. The IASB was informed that the calculations required are sometimes complex and that not all entities disclose the information necessary to make the appropriate adjustments.*

29 *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 make adjustments for non-performance risk.*

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

30 *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'.*

31 *A few stakeholders said that 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, which 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.*

32 *However, the IASB concluded that a rate that excludes non-performance risk also fulfils the criteria listed in paragraph 30 above. The IASB noted 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.*

33 *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 that 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.*

34 *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.*

35 *In relation to the argument listed in paragraph 33(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*

Standards, observable market credit spreads are available and could be used as a benchmark/proxy for non-performance risk.

Application guidance

36 *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 estimating a risk-free rate for measuring provisions.*

(b) *Provisions within the scope of IAS 37 vary widely in their terms and 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

37 *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.*

38 *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.*

39 *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.*

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

40 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 and enhance comparability for IFRS reporting entities.

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

42 EFRAG also 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).

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

Excluding non-performance risk from the rate (rates)

44 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

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

referenced to an observable market rate/proxy for a risk-free rate, such as 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 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. 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.

45 The ED does not specify how an entity determines an appropriate risk-free rate. EFRAG acknowledges that in practice a risk-free rate is determined by reference to a market proxy, such as the yield on a low-risk government bond. EFRAG notes that there are multiple risk-free rates across different jurisdictions, with no 'fit-for-all' risk-free rate. EFRAG therefore agrees that being too specific on the risk-free rate to be used could be challenging and result in unintended consequences. EFRAG therefore agrees with the IASB's approach to remain principles-based and stating (paragraph 47 of the ED) that the risk-free rate should reflect characteristics that are relevant to the liability, such as current market assessments of the time value of money. EFRAG also considers that the proposal to require an entity to disclose the approach it has used to determine the rate (or those rates) will provide investors with information to be able to make any adjustments they consider necessary in their own analysis.

46 Similar to the IASB, EFRAG has received feedback from its stakeholders informing that determining non-performance risk could require more judgement and lead to more variability in 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.

47 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. Specifically, entities with a poor credit rating would report smaller

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

liabilities, and those with weakening credit ratings might report gains in profit or loss and increases in shareholder wealth. In this regard, EFRAG also notes that IFRS 9 *Financial Instruments* requires, for the measurement of financial liabilities designated as at fair value through profit or loss, 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).

48 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 financial statements are prepared under a going concern assumption, i.e. 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)

49 EFRAG notes the following areas in need of 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, either.

(b) Whether the requirement to use a discount rate not including non-performance risk could be considered a fair value measurement under IFRS Accounting Standards. In

[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).

the view of EFRAG, this would not be the case, and the proposals might 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. If this difference would not be reflected in the measurement of a related asset (following IFRIC 1 *Changes in existing decommissioning, restoration and similar liabilities*), it would be recognised in profit or loss.

Disclosure – discount rates

50 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).

51 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.

Other observations

52 EFRAG notes that entities can currently either include or exclude inflation expectations when estimating the future expenditure required to settle its present obligation and then discount this amount using the corresponding nominal or real discount rate. With IFRS 18 *Presentation and Disclosure in Financial Statements* now mandating that the increase in the discounted amount of a provision arising from the passage of time be presented in the financing category of profit or loss, the expenses reported in the financing category will be higher when inflation is reflected in the estimates of the future expenditures and the discount rate, compared with the situation where a real discount rate is used. Accordingly, if the IASB does not mandate how to take into account inflation when estimating and discounting future expenditure to settle a present obligation, entities could do this in different manners and consequently reporting different operating and finance income, all other things being equal.

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. 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. 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?

Question 4 – Transition requirements and effective date

Notes to constituents – summary of proposals in the ED

Transition requirements

53 *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.*

54 *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) *remeasure 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.*

55 *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

56 *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; and*

(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)

57 *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; and*

(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.*

58 *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)

59 *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.*

60 *As per paragraph BC95 of the ED, the IASB concluded that applying the change in the 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 and 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.*

61 *As reflected in agenda paper 22b of the June 2024 IASB meeting, in 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 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.

62 *Therefore, 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.*

63 *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.

64 *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

65 *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

66 The proposed amendments to 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).

67 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.

68 Therefore, EFRAG agrees with the 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

69 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, which specifies 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.

70 Similar to the arguments in support of 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 that the information provided by doing so is unlikely to be sufficiently useful to justify the costs that the entity might incur.

71 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)

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

73 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 the initial recognition of the provision and the date of transition. This would be burdensome and costly for entities to do.

[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.

74 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. Therefore, EFRAG recommends including the example provided in the Appendix of the 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.

75 In addition, EFRAG recommends that the IASB consider whether an impairment test under IAS 36 *Impairment of Assets* should be conducted for the respective assets impacted by a change in the measurement of provisions due to the proposed changes to the discount rate. As these proposals could result in higher provisions for 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 cash-generating unit, their increased carrying amount may trigger an impairment.

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

Effective date

77 With respect to the effective date, EFRAG agrees with allowing 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

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.

4.2 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

78 *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).*

79 *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.*

80 *It is also noted that IFRS 19 includes most of the requirements in other IFRS Accounting Standards to disclose discount rates. For example, the requirements in IAS 36 and 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.*

81 *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 the disclosure of the approach used to determine the discount rate. The IASB concluded that the costs of providing this information would exceed the benefits to the users of eligible subsidiaries' financial statements and 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

82 EFRAG 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 sees merit in the proposal to require information about the approach used to determine the discount rate for entities within the scope of IFRS 19.

83 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. In addition, EFRAG understands that, as specified in paragraph BC105 of the ED, barring IFRS 17 *Insurance Contracts*, none of the other requirements in IFRS 19 require disclosure of the approach used to determine the discount rate. However, EFRAG notes that in relation to removing this disclosure requirement for entities in the scope of IFRS 19, the ED does not explain how the principles for reducing disclosures specified in IFRS 19 are applied[8]. EFRAG therefore recommends that the IASB clarify the application of these principles.

84 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

[8] As per paragraph BC33 of IFRS 19, these principles are the following: (a) Users of the financial statements of eligible subsidiaries are particularly interested in information about short-term cash flows and about obligations, commitments or contingencies, whether or not they are recognised as liabilities. (b) Users of the financial statements of eligible subsidiaries are particularly interested in information about liquidity and solvency. (c) Information on measurement uncertainties is important for eligible subsidiaries. (d) Information about an entity's accounting policy choices is important for eligible subsidiaries. (e) Disaggregations of amounts presented in eligible subsidiaries' financial statements are important for an understanding of those statements. (f) Some disclosures in IFRS Accounting Standards are more relevant to investment decisions in public capital markets than to the transactions and other events and conditions encountered by typical eligible subsidiaries.

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

85 *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 that 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 of 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; and*

(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

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

87 EFRAG also generally agrees with the amended and additional examples in Section C should the proposed amendments to IAS 37 be pursued but has the following comments.

(a) Example 3 — Offshore oilfield: Similar to the notation used for Example 6, an '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 the end of the reporting period: IAS 19 deals with termination benefits. According to paragraph 165 of IAS 19, an entity shall recognise a liability and expense for termination benefits at the earlier of the following dates: (a) when the entity can no longer withdraw the offer of those benefits and (b) when the entity recognises costs for a restructuring that is within the scope of IAS 37 and involves the payment of termination benefits. The linkage with these requirements should be explained in the example. In addition, 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: As for Example 5A, the linkage with the requirements of IAS 19 should be explained. In addition, 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 of 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.

(f) Example 13B — A levy on an entity operating as a bank on the last day of its annual reporting period: The comment made for Example 13A also applies to Example 13B. In addition, although it is explained under the 'past event condition' assessment that the resulting present obligation accumulates over the time period, it would probably be more useful to include examples illustrating how interim financial statements would be affected under the scenario explained in the example rather than what the effect at the end of the reporting period would be.

Other comments

Notes to constituents – summary of proposals in the ED

88 *The ED asks whether respondents have comments 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

89 The IASB has left unchanged paragraph 37 of current IAS 37, which states: 'The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time.' In practice, this measurement principle can be interpreted in different ways. One way is to measure the provision based on estimated costs to be incurred to fulfil the obligation. Another interpretation is to measure the

provision based on a stand-alone selling price, which would have to be paid to transfer the obligation to a third party. These interpretations could yield a very different outcome in situations where the entity can either fulfil the obligation itself or transfer it to another party (and possibly the recognition of a margin if the entity performs itself). For the same reasons as other proposals in the ED (i.e. improve comparability), the IASB should clarify the measurement basis for provisions on this aspect also in relation to the issue mentioned in paragraph 49(b) above.

90 EFRAG does not have additional comments to the proposals in the ED.