EFRAG
Financial reporting

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

1 April 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 Accounting Standards in the European Union and European Economic Area.

The ED proposes targeted improvements to one of the criteria for recognising a provision (the present obligation recognition criterion) and to two aspects of the requirements for measuring a provision.

Present obligation recognition criterion

In relation to the present obligation recognition criterion, EFRAG welcomes the aims of the proposed amendments to reduce compliance costs, provide more useful information to users of financial statements, and clarify the requirements. EFRAG, however, questions whether all of these objectives will be met by the proposals of the ED. EFRAG thus considers that the proposals in their current form will not reduce compliance cost as they would require more judgement to be made. In relation to the usefulness of the information, EFRAG appreciates the withdrawal of IFRIC 21 but notes that the ED does not (completely) address the concern expressed in relation to IFRIC 21. EFRAG assesses that the proposals clarify the requirements for some types of provisions but create less clear guidance for other types of provisions. To clarify the guidance, EFRAG recommends that the IASB amend how legal and constructive obligations are defined in the ED, clarify what an exchange transaction is, clarify what actions would qualify as past event, clarify when an action is taken over time and clarify when an entity has no practical ability to avoid taking an action. Following these amendments, it would also be important to field test the requirements.

EFRAG also has some suggestions on how to improve the examples included in the proposed guidance on implementing IAS 37.

Measurement – expenditure required to settle an obligation

EFRAG supports the proposal to specify that the costs to settle a present obligation comprise the costs that relate directly to that obligation. However, EFRAG asks for additional guidance and accompanying examples on whether and how 'other direct costs' (such as external and internal legal advisers) are included in the measurement of litigation and warranty provisions. EFRAG also asks for clarification on some other aspects of the proposal, which are detailed in the Appendix.

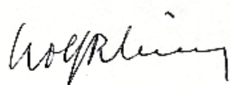
Measurement – discount rates

EFRAG also appreciates the IASB's efforts to reduce diversity in practice by specifying that the rate that 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 it considers that they will improve comparability, also taking into account the additional note disclosures proposed. It also agrees with requiring the use of a rate that does not reflect non-performance risk, as reflecting non-performance risk in the discount rate(s) has a counterintuitive impact on the resulting measurement. However, notwithstanding our support, EFRAG has a number of observations and recommendations for the IASB on this proposal, including on the proposed disclosures.

EFRAG assesses that the IASB would be able to finalise the amendments related to measurement (the expenditure required to settle an obligation and the discount rate) faster than the amendments related to the present obligation recognition criterion. EFRAG assesses that it would take some time to finalise the latter requirements, as there are several significant issues that need to be addressed.

If you would like to discuss our comments further, please do not hesitate to contact Isabel Batista, Vasilis Dionelis, Tamara Eiffes, Aleksandra Sivash, 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

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

1 EFRAG agrees with the aim of the proposed amendments, i.e. to clarify the requirements and provide more useful information to users of financial statements. According to paragraph IN3 of the ED, the amendments would affect provisions for costs, often 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. Provisions for some of these costs would be accrued earlier and progressively instead of at a later point in time, according to the ED. While EFRAG agrees that some provisions would be accrued earlier, it notes that the effects, including the pattern of the recognition of the provision, will vary from provision to provision.

2 EFRAG acknowledges that the proposed requirements are based on the guidance related to the definition of a liability included in the Conceptual Framework for Financial Reporting

and that following such guidance is an appropriate starting point for making requirements that will result in useful information. EFRAG, however, notes that the proposals of the ED, and the manner in which these are reflected in the examples included in the proposed Guidance on implementing IAS 37, represent one possible interpretation of the requirements in the Conceptual Framework. EFRAG thus considers that the guidance included in the Conceptual Framework could also have resulted in other requirements than those proposed in the ED.

3 In the webcast made by the IASB on the ED[1], it was stated that the aims of the amendments related to the recognition of provisions are to: (1) reduce compliance costs, (2) support consistent application and (3) provide earlier information to users of financial statements.

4 EFRAG does not consider that the aim of reducing compliance costs will be met by the requirements of the proposals, as they will result in more judgement having to be exercised.

5 The aim of supporting consistent application could be met for some types of provisions but not for others (such as those levies that could be affected by the proposals). EFRAG thus notes that input it has collected in order to be able to assess the ED has shown that the requirements of the ED are interpreted very differently from person to person.

6 In relation to the aim of changing the timing of recognition of some provisions, as stated in IN3 of the ED, EFRAG welcomes the withdrawal of IFRIC 21 Levies. 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.

7 While EFRAG thus appreciates the withdrawal of IFRIC 21, it notes that the ED does not (completely) address the concern expressed in relation to IFRIC 21. Some types of levies that are currently recognised at a point in time will also be recognised at a point in time under the proposals of the ED (although some provisions may be recognised earlier). In addition, some levies that are currently recognised over a period of time may be recognised at a point in time under the proposals (for example, some levies that depend on the entity

[1] https://www.ifrs.org/projects/work-plan/provisions/iasb-proposed-improvements-to-requirements-provisions/

holding an asset on 31 December 20X1, but where the amount to be paid depends on how many months the entity would be operating in 20X2, might be affected).

8 The following paragraphs include EFRAG's suggestions on how to improve the proposals of the ED. In particular, EFRAG considers it essential to clarify the actions that would qualify as relevant past events.

Amending how legal and constructive obligations are defined

9 The ED introduces additional requirements/guidance on the obligation condition. From input EFRAG has received on the interpretation of these requirements, it appears that these requirements are interpreted in different manners.

10 Paragraphs 14B and 14C of the ED describe the mechanism for imposing a responsibility. Uncertainty exists on what this 'mechanism' could be. To narrow down the scope of the 'mechanism', EFRAG suggests that paragraph 14C should not state that 'the mechanism imposing a responsibility could be …' but should instead state that the 'mechanism imposing a responsibility would either be' legal or constructive.

11 Paragraph 14F of the ED describes when an entity does not have a practical ability to avoid discharging a responsibility in the case of a legal and constructive obligation, respectively. EFRAG understands that one of the reasons for introducing the detailed requirements was to address issues related to responsibilities that cannot be enforced by court.

12 EFRAG, however, observes that the proposals have created some uncertainty. This uncertainty is, among other things, related to how to assess the economic consequences for the entity of not discharging its responsibilities (e.g. whether 'reputational damage' and 'detection risk' should be considered). In this respect, EFRAG questions whether it is even appropriate to have to assess the economic consequences of non-compliance with legal requirements. Another aspect is the assessment of whether the economic consequences for the entity of not discharging the responsibility are expected to be significantly worse than the costs of discharging it. EFRAG is concerned about this requirement, as it could/would result in no provision being recognised in relation to a responsibility where the economic consequences for the entity of not discharging the responsibility are expected to be no more than slightly higher than the economic consequences of discharging it. From input received, EFRAG understands that in some jurisdictions the costs of not discharging a responsibility are similar to the costs of discharging it. EFRAG is concerned that no provision would be recognised in all of these cases. EFRAG considers that there might still be an amount that would have to be transferred although it would be lower than the 'original' amount, and the counterparty might be different.

13 Based on the observations noted above, EFRAG therefore recommends that the IASB reconsider whether the assessment of the economic consequences of not discharging a responsibility is necessary for legal obligations. If there are circumstances for which it would be necessary, the assessment of the economic consequences should be limited to these cases (e.g. for responsibilities that cannot (or have not) been enforced by courts). The IASB could also consider whether the assessment would then be more relevant for constructive obligations.

14 In its description of the obligation condition, the IASB could also consider explaining (e.g. in the Basis for Conclusions) whether 'virtually certain to be enacted as drafted' in paragraph 14G is identical with the criterion 'enacted or substantively enacted' in paragraph 46 of IAS 12 *Income Taxes*. Similarly, the IASB could harmonise the notion of 'significantly worse' used in paragraph 14F of the ED and that of 'more adverse' used in examples 13A, 13B and 14 in the proposed Guidance for implementing IAS 37.

Clarify what an exchange transaction is

15 EFRAG notes that it could be debated whether the payment of a levy should always be considered a transfer or whether it could sometimes be an exchange transaction. To avoid diversity in practice on this issue, EFRAG recommends that the IASB consider stating that the payment of a levy is not an exchange transaction.

16 EFRAG also recommends that the IASB specify that, when assessing whether a transaction would be a transfer or an exchange transaction, the 'party' to be considered (in paragraph 14L of the ED) is the party to which the particular obligation in question is owed, as described in paragraph 14E of the ED.

Clarify what actions would qualify as a relevant past event

17 From input that it has received, EFRAG assesses that it is currently not sufficiently clear what actions would qualify as a relevant past event. EFRAG considers that the following would need to be clarified.

(a) The effect of an action that would trigger the recognition of a provision. Paragraph 14N of the ED specifies that an entity's obligation becomes a present obligation that exists as a result of a past event when the entity has taken a specific action and, as a consequence, will or may have to transfer an economic resource it would not otherwise have had to transfer. EFRAG understands that, according to the ED, only an action that is strictly necessary for potentially having to transfer an economic resource should be considered as an action that results in an entity's obligation becoming a present obligation. For example, if a levy depends on an entity holding a

specific type of asset on a particular date (e.g. 1 January), purchasing the asset on the day before (e.g. 31 December) would not be considered an action that results in the entity having to transfer an economic resource it would not otherwise have had to transfer. This is because it is only necessary under the levy that the entity be holding the asset on the particular date (1 January). EFRAG, however, considers the ED to be inconsistent with regard to what the consequence of an action should be for it to be a necessary action for an entity's obligation to become a present obligation. In some cases, a necessary action seems to be only the action that is necessary for the entity having to transfer an (i.e. any) economic resource under a levy (that is, if an action would not be strictly necessary for the entity to have to transfer an (any) economic resource under, e.g. a levy, that action would not be considered to result in the entity (potentially) having to transfer an economic resource it would not otherwise have had to transfer). In other cases, a necessary action could also be an action that will result in the entity having to transfer an additional economic resource (e.g. in relation to a levy).

An example (Example A) to illustrate where it seems the ED only considers actions that are strictly necessary for an entity to have to transfer a (any) resource under a levy is where an entity will have to pay a levy if it is operating on 1 January 20X2. If the entity has been operating in 20X0, the levy will be determined based on the revenue the entity earned in 20X0. If the entity did not operate in 20X0, the levy will be based on revenue earned in 20X1 (if the entity only operates in some months of 20X1, the amount will be adjusted to reflect a 12-month period). In this case, EFRAG understands that the entity should only recognise a levy on 1 January 20X2 under the proposals of the ED, even if it is generating revenue in 20X0, and would thus have to transfer additional economic resources in relation to the levy the more revenue it generates in 20X0. This is because generating revenue in 20X0 is not a necessary action for having to transfer an economic resource following from the levy. If the entity had not operated in 20X0, it would still have to pay the levy, but it would just have been calculated based on the revenue generated in 20X1. The only action that is necessary for the entity having to transfer a resource under the levy is therefore that it is operating on 1 January 20X2.

However, this approach seems to be inconsistent with Example 13A—A levy on revenue in the proposed Guidance on implementing IAS 37. In Example 13A, the obligation accumulates as the entity generates revenue in 20X0. In this example, the entity thus recognises a provision when it earns its first revenue in January 20X0,

even if this is not a necessary condition for the entity having to transfer an (any) economic resource under the levy. If the entity had not generated any revenue in January 20X0, it would still have to pay an amount under the levy, which would result in a provision being recognised in relation to the levy on the 30 June 20X0 statement of financial position, as long as the entity would generate revenue before 30 June 20X0. Contrary to Example A, Example 13A of the Guidance on implementing IAS 37 thus seems to consider that actions that will result in additional economic resources under a levy can also be considered actions that will or may result in an entity having to transfer an economic resource it would not otherwise have had to transfer.

(b) <u>How to identify the features of a levy that qualify as an action for the purpose of applying the proposed requirements</u>. Levies are based on local laws, which specify when an entity is subject to a levy and how it is measured. These requirements will have to be 'translated' into 'actions' and 'thresholds' to apply the proposed requirements. This may be challenging for levies based on balance sheet items (e.g. amounts of deposits or rental value of a property) as well as for levies based on other measures (e.g. revenue recognised under local accounting standards that is significantly different from revenue under IFRS Accounting Standards), particularly when levies are measured by reference to amounts in a period but are only payable depending on the number of months of activities in a different period.

(c) <u>Whether implicit and/or passive actions should be considered</u>. It appears that, according to the proposed guidance on implementing IAS 37 (e.g. Example 13C on property tax) and the Basis for Conclusions in the Exposure Draft (e.g. paragraphs BC34–BC36), only actions that are necessary for having to transfer a resource should be taken into account. Accordingly, if an entity acquires a building on 30 December 20X1 and has to pay a levy if it holds that building on 31 December 20X1, the only action that is relevant for assessing the past event condition is whether the entity holds the building on 31 December 20X1. This is because acquiring the building or holding it before or after 31 December 20X1 is not a necessary condition for having to pay the levy. It is only a necessary condition that the entity hold the building on 31 December 20X1. The entity would thus also have had to pay the levy if it had received the building as a gift or if it had acquired the building on 31 December 20X1 and sold it again the day after. Regarding the past-event condition, the 'no practical ability to avoid' seems to apply only to actions that are necessary. In other words, even if the entity would not have a practical ability to avoid holding a building on 31 December 20X1, if it acquires the building on 30 December 20X1 this should not

be considered, as acquiring the building is not a necessary action in relation to the levy. However, if this interpretation of the proposals is correct, it could also mean that the following two levies could be accounted for differently, although they seem economically similar:

(i) a levy explicitly requiring entities that at a point in time have acquired, received or developed a specific asset and are holding this specific asset on 31 December to pay a levy based on the value of this asset at that date; and

(ii) a levy only explicitly requiring entities holding a specific asset on 31 December to pay a levy based on the value of this asset at that date.

Although the example above considers actions taken at a point in time, the issue also arises for actions taken over time.

(d) <u>When separate features are separate actions</u>. A levy could, for example, depend on the number of months an entity conducts an activity in 20X2 and the entity having access to a building with a rental value on 31 December 20X0. In these cases, it could be discussed whether the levy refers to two actions (first, holding a property with a rental value on 31 December 20X0, and second, conducting an activity in 20X2) or one action (running an activity in 20X2 and having had access to an asset with a rental value on 31 December 20X0). Accordingly, it needs to be clarified when separate features are separate actions.

(e) <u>Whether the sequence of features over time matters in the identification of actions</u>. The example in (d) above illustrates that there could be an issue on how to separate features into separate actions. In this regard, it could be clarified whether the sequence of features over time matters in the identification of actions (i.e. whether the fact that two features refer to different points in time would mean that these separate features should be considered to be separate actions).

(f) <u>Whether all thresholds related to a levy qualify as a threshold under the ED</u>. Some levies may only apply to certain entities. For example, some levies may only apply to entities of a certain size, measured by reference to, for example, the entity's revenue. The amount to be paid could be partly related to the entity's revenue. In such a situation, it may not be clear whether the revenue threshold used for the scope of the levy would also qualify as a threshold in the sense of paragraph 14P of the ED.

(g) How to distinguish between recognition and measurement. Input collected by EFRAG as part of responding to the ED has indicated that some stakeholders consider the requirements in the ED to confuse recognition and measurement. EFRAG considers that one of the factors for this comment is that it is not clear what actions affect recognition and what actions affect measurement (particularly whether/when an action that will result in the entity having to transfer an additional economic resource is an action affecting measurement or recognition (see (a) above)). Another factor is the description of the legal mechanism. As noted in paragraph 12 above, it can be considered a measurement issue if the economic consequences for an entity of not discharging a responsibility are not significantly worse than discharging it (and not a recognition issue). Thirdly, people may have differing views on what relates to recognition and what relates to measurement. For example, some consider that a levy relates to the period in which it becomes chargeable, and if it will be based on, for example, revenue generated in a previous year, the revenue generated in that year is a factor affecting measurement and not recognition. For all these reasons, it will be important for amendments on the present obligation recognition criterion to be clear on what factors relate to measurement and what factors relate to recognition. One of the efforts that could be done in this regard would be to amend or add illustrative examples to illustrate the application of the proposed requirements in situations where two actions are further separated in time. For example, Example 13A could illustrate the proposals in a case where the amount of the levy is a percentage of the revenue an entity generates in the market during the year to 31 December 20X0. However, only entities that are operating in the market on 1 January 20X2 would be within the scope of the levy.

Clarify when an action is taken over time

18 The ED amends the requirements on when the past event condition is met by specifying when the condition is met for two different scenarios:

(a) when an entity has an obligation to transfer an economic resource only if it takes two (or more) separate 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.

19 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.

20 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 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.

21 Other cases where the input collected by EFRAG suggests differing views on which of the scenarios listed in paragraph 18 apply are:

(a) when 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;

(b) when there are two actions that are necessary to trigger an obligation to transfer an economic resource and the last action would be an action that is taken over time; and

(c) when two actions are necessarily connected but not identical, for example, if a levy were based on the level of deposits a bank holds on 31 December 20X0 and on the entity operating as a bank on 31 December 20X1.

22 EFRAG also recommends that the guidance on how to account for actions that are taken over time, as the example included after paragraph 14P of the ED, be supplemented by illustrations on how the provisions would be calculated.

Clarify when an entity has no practical ability to avoid taking an action

23 The term 'no practical ability to avoid' is interpreted very differently. This has, for example, been documented in EFRAG's work on accounting for variable consideration. EFRAG therefore assesses that additional guidance on this assessment would be necessary. Input EFRAG has received in relation to its work related on this comment letter has also revealed that there is uncertainty related to the interpretation of the term, for example, on whether a bank would/would not have a practical ability not to operate as a bank within two years. Additionally, for entities preparing interim financial statements, it could be difficult to assess from which quarter an entity would not have a 'practical ability to avoid' taking an action. A related question was also how the proposal would apply to various situations, for

example a situation where an entity has to pay each year a fund up to a certain amount. Every year, the fund communicates the amount of the annual levy and the only way the entity can avoid the payment would be to cease operating.

24 EFRAG also notes that paragraph 14R of the ED 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.

Consider other proposals that could enhance the understandability of requirements

25 To make the requirements in IAS 37 more understandable and/or reduce diversity in practice, the IASB could also consider:

(a) reinstating paragraph 18 of IAS 37 or include similar wording to ensure that no provision is recognised for costs that need to be incurred to operate in the future. In this context, EFRAG highlights that many of its stakeholders commented on how useful paragraph 18 of IAS 37 has been in practice for enforcing the principle that future operating expenses should not be provided for;

(b) distinguishing 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, recognised only when it can be reliably measured);

(c) moving 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);

(d) removing the statement in paragraphs 15 and 16 of the ED whereby uncertainty about whether the present obligation criterion is met is 'rare' (as it does not seem particularly rare);

(e) clarifying how to implement the concept of probability when it applies to many events or a limited number of events (as in Example 1 and Example 10 included in the proposed Guidance on implementing IAS 37); and

(f) improving the connection between IAS 37 and IAS 19 regarding termination benefits.

Next steps of the IASB

26 EFRAG notes that addressing the issues above could take time and could also result in a different recognition pattern and/or timing of provisions compared to constituents' interpretations based on the current wording of the ED. It would therefore be important for the IASB to seek considerable input on its redeliberation before issuing any amendments. In particular, it would be important for the IASB to conduct field tests. EFRAG therefore expects that the amendments on the present obligation recognition criterion will take significantly longer time to complete compared to the amendments related to the measurement of a provision.

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

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

27 EFRAG supports the proposal to specify that direct costs (as described in paragraph 40A of 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.

28 EFRAG notes that the ED proposal covers all types of provisions and thus not only onerous contracts. EFRAG also notes that including directly related costs in the measurement of a provision for the delivery of goods or services would be consistent with some IFRS Accounting Standards, where direct costs are included in the acquisition/manufacture cost of an asset.

29 However, other IFRS Accounting Standards, for example IAS 19, do not require or allow the inclusion of costs that relate directly to the obligation (e.g. costs for using actuarial services to determine benefits) when measuring the defined benefit obligation. As explained below,

EFRAG asks for additional guidance and accompanying examples on whether and how 'other direct costs' (such as external and internal legal advisers) are included in the measurement of litigation and warranty provisions (or similar provisions not linked to goods or services).

Illustrative examples

30 EFRAG considers that it would be useful to include additional application guidance and illustrative examples on the type of 'other directly related' costs (such as external and internal legal advisers) that an entity should include when measuring provisions, particularly litigation and warranty provisions.

31 EFRAG highlights that there is no unique understanding of the term 'directly related' and the extent to which pro rata fixed costs are considered directly related to a provision. Without additional guidance and examples of which other directly related costs should be included (or excluded) from the measurement of a provision, particularly legal and warranty provisions, EFRAG considers there is a risk that diversity will remain/arise when applying the proposed paragraph 40A.

32 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 including 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.

33 Furthermore, EFRAG understands that for these types of provisions (litigation and similar provisions), paragraph 40A may be difficult to apply because some might consider the provision a transfer of resources – in which case such costs could be recognised as a provision – and others might view it as an exchange of an economic resource – in which case such costs would not be recognised as a provision. EFRAG suggests that the IASB clarify that the assessment of whether a cost is a transfer or part of an exchange should be done in relation to the counterparty to the transaction. For example, if the counterparty in a provision is a person suing the entity, the legal fees should not be considered an exchange transaction when measuring this provision, as the service (asset) acquired for the legal fees is consumed in relation to this provision. However, in the relationship between the entity and the lawyer, the legal fees should be considered an exchange transaction (as the entity pays an amount and receives a service (an asset) in return, which is not 'consumed' as part of this transaction).

34 Finally, some of EFRAG's stakeholders have highlighted potential complexity and both one-off and ongoing costs in determining other directly related costs. Complexity is likely to arise in relation to litigation provisions where, for example, the allocation of costs of the legal department do not represent a routine task for most entities. EFRAG considers that additional guidance and examples of which types of 'other directly related costs' ought to be included or excluded in the measurement of a provision will help entities to more effectively implement the proposed paragraph 40A and thus reduce the costs of doing so.

Interaction between paragraph 37 and proposed paragraph 40A

35 EFRAG considers that the existing requirements in IAS 37 (paragraph 37[2]) allow a provision to be measured either on the basis of a fulfilment value (in line with proposed paragraph 40A) or on the basis of a transfer value (the amount that an entity would pay to transfer the obligation to a third party). These different interpretations could yield different outcomes in situations where the entity can either transfer it to another party or fulfil the obligation itself (including potential for the recognition of a margin if the entity fulfils the obligation itself). For the purposes of improving comparability, EFRAG therefore recommends that the IASB clarify the measurement basis for provisions on this aspect.

Recognition of future costs and deletion of paragraph 18

36 As mentioned in paragraph 25(a) above, EFRAG suggests reinstating paragraph 18 of IAS 37 or similar wording. EFRAG also considers this could be useful in relation to assessing the costs to be included when measuring a provision. EFRAG thus considers that without such a statement the allocation of internal directly related costs, such as the costs of corporate assets and personnel working in general headquarters, could lead to the recognition of future costs.

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

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).

[2] Paragraph 37 of current IAS 37 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.'

> 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

37 EFRAG generally 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.

38 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.

39 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). EFRAG therefore recommends that the IASB describe in the amended standard the objective of setting the discount rate for provisions (see paragraph 48(a) below).

40 Furthermore, notwithstanding our support, EFRAG has a number of observations and recommendations for the IASB on this proposal, which are discussed in the paragraphs below.

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

Excluding non-performance risk from the rate (rates)

41 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].

42 The ED does not specify how an entity determines an appropriate risk-free rate. EFRAG notes that there are multiple risk-free rates across different jurisdictions, with no 'fit-for-all' risk-free discount rate, making it challenging to be too specific on the risk-free rate to be used. As explained in paragraph 71 of the Basis for Conclusions accompanying the ED, a risk-free rate is more objective as it can be referenced to an observable market rate/proxy for a risk-free rate, such as a current yield on a low-risk government bond. 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 for around 100 years. Accordingly, there is a need for being able to extrapolate current rates.

43 EFRAG considers that the clarifications provided by paragraph BC68 of the Basis for Conclusions accompanying the ED 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 and recommend that these clarifications be incorporated into the Standard.

Other observations on non-performance risk

44 EFRAG also shares the concern noted in paragraph B78 of the Basis for Conclusions accompanying the ED 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 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

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

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).

Disclosure proposals

45 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). The 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).

46 The proposed disclosures will provide investors with information to be able to make any adjustments they consider necessary in their own analysis and alleviate concerns on the use of different approaches to determine a risk-free rate(s). As noted by the IASB in paragraph BC84 of the Basis for Conclusions accompanying the ED, 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.

47 However, EFRAG notes that some of EFRAG's stakeholders expressed concern with the volume and granular nature of the proposed disclosures for larger groups which apply multiple discount rates across different jurisdictions. EFRAG therefore recommends that the IASB consider how the principles of aggregation and disaggregation in relation to the disclosure developed in IFRS 18 *Presentation and Disclosure of Financial Statements* could be applied in relation to the disclosure proposed in paragraph 85 of the ED – in other words, whether entities could disclose the proposed information in a more 'aggregated' manner that would still assure users receiving sufficient information to understand line items related to provisions.

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

48 EFRAG notes the following additional areas in need of clarification.

(a) *Long-term provisions – liquidity adjustments* – EFRAG recommends that the IASB consider whether additional guidance on when and how liquidity adjustments as referred to in paragraph BC82 of the ED should be made for a risk-free rate for long-term provisions would be helpful. EFRAG notes that some of its stakeholders operating in certain sectors consider that for long-term provisions the discount rate should be adjusted with an illiquidity adjustment. These stakeholders note that an illiquidity adjustment reflects the fact that low-risk government bonds on which observable risk-free rates are based are both relatively short-term and highly liquid.

EFRAG notes that a conceptual argument used for excluding non-performance risk in the measure of a provision is that the measurement of the provision should tell investors the amount the entity would need to invest in risk-free assets at the reporting date to fund the settlement of a provision (see (a) in Table B1 of the Basis for Conclusions accompanying the ED). This guidance (i.e. for determining a rate that an entity would obtain from risk-free assets, which it would need to invest into funding the settlement of a provision) could serve as the objective for the determination of an appropriate discount rate as recommended above. EFRAG observes that IFRS 17 *Insurance Contracts* also requires the consideration of liquidity when determining the discount rate used for discounting future cash flows (see paragraphs 36 and B78–B84 of IFRS 17).

(b) *Double-counting* – 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.

(c) *IFRS 3 Business Combinations* – In the view of EFRAG, the requirement to use a discount rate not including non-performance risk would not be considered a fair value measurement under IFRS Accounting Standards, 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 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. EFRAG recommends that the IASB provide an exception from fair value accounting for provisions in IFRS 3.

(d) *Inflation adjustments* – 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 to 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. EFRAG therefore recommends that the IASB consider how inflation should be addressed in IAS 37. The IASB could also consider requiring entities to disclose whether they have applied a nominal or real discount rate, enabling financial statement users to make informed adjustments where necessary. Disclosure would enhance transparency and comparability.

Question 4 – Transition requirements and effective date

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

49 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).

50 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.

51 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

52 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[5] and (2) without restating comparatives.

53 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.

54 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*[6].

Simplified retrospective approach for changes in discount rates (option)

55 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.

56 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

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[5] 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).

[6] References in June 2018 IFRIC staff paper.

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.

57 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.

58 In this respect, EFRAG suggests that the IASB consider further explaining the approach in the Basis for Conclusions accompanying the amendments. 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, there may also be cases where considerations such as the unwinding of the discount are also relevant.

59 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.

Differences between transition requirements for costs and discount rates

60 EFRAG notes that the differences between the transition requirements for the costs included in the measure of a provision and those for determining discount rates used to discount provisions may not be useful.

61 EFRAG acknowledges that the proposed transition requirements on the costs to include when measuring a provision are in line with the transition requirements for assessing whether a contract is onerous. Similarly, the transition requirements on the discount rate

are in line with those in paragraph D21 of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, on decommissioning liabilities included in the cost of property, plant and equipment.

62 However, EFRAG considers that there may be some types of provisions (or some types of entities) that will be affected by both the proposed changes to the cost and the discount rate proposals. In those cases, EFRAG assesses that users would find helpful if only one reporting period would be affected by the impact of the proposals (rather than the comparatives being affected by the new requirements related to the discount rate and the current figures being affected by the requirements related to the cost to be included when measuring a provision).

63 Therefore, EFRAG recommends mandating the application of the new requirements related to the discount rate to use and the cost to include in the measurement of a provision as of the same date. Whether this date should either be the transition date or the date of initial application of the requirements would depend on the effective date of the amendments compared to the date when the amendments are published.

64 EFRAG also suggests adopting the same approach for the amendments to the costs and discount rates with regard to whether comparatives should be adjusted.

Effective date

65 With respect to the effective date, EFRAG agrees with allowing sufficient time (i.e. the effective date being at least 24 months after the publication of the amendments) to prepare for the new requirements, with earlier application permitted. This would allow stakeholders to familiarise themselves with the amendments, which may represent a significant change in practice.

Question 5 – Disclosure requirements for subsidiaries without public accountability

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

66 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.

67 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[7]. EFRAG therefore recommends that the IASB clarify the application of these principles.

68 Taking the above into consideration, EFRAG on balance supports the proposed amendments to IFRS 19.

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[7] 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) disaggregation of amounts presented in eligible subsidiaries' financial statements are important for an understanding of those statements; and (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.

Question 6 – Guidance on implementing IAS 37

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:

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?

EFRAG's response

General comments

69 EFRAG agrees with expanding the decision tree in Section B and acknowledges the IASB's efforts to illustrate the proposals with the amended and additional examples in Section C; however, EFRAG emphasises the need for further clarity regarding the illustrative examples.

70 EFRAG's comments on Question 1 highlight the concerns raised regarding the proposed recognition criterion (the present obligation recognition criterion) and application challenges specifically with regard to levies, which also impact the illustrative examples. The IASB, in its dedicated webcast, emphasised that the illustrative examples should help stakeholders understand the proposals of the ED[8]. Outreach events conducted by EFRAG also indicated that constituents attempted to understand the proposed amendments through the illustrative examples in the implementation guidance but expressed concerns that the outcomes may differ due to varying interpretations (constituents arrived at different conclusions when considering the examples or were surprised by the outcome of the examples because their understanding of the proposals was different). Therefore, although EFRAG assesses the examples to be useful, it notes that it is crucial for the

[8] Webcast: Exposure Draft *Provisions – Targeted Improvements*

amendments in the Standard to be clear and unambiguous by themselves, not only because the Guidance on implementing IAS 37 is not part of IAS 37 (and will accordingly not be endorsed in the EU), but also because illustrative examples can never cover all types of situations.

71 EFRAG has expressed concern regarding the imprecise language used in the ED, which is also evident in the illustrative examples. One point in need of clarification is the use of the terms 'management judges' and 'management assesses', which carry subjective meaning and can pave the way for diversity in practice. As mentioned in our response to Question 1, EFRAG also had concerns on the assessment of 'no practical ability to avoid' in relation to contract-based levies.

72 EFRAG recommends that illustrative examples set out more clearly interim assessments and address the application of recognising and accumulating provisions over time in interim periods and dates. Furthermore, as noted in paragraph 17(g), EFRAG considers that it could be useful to provide examples that would illustrate the effects, if any, of the requirements on levies where the time interval between two actions would be multiple years.

Comments on specific illustrative examples

73 EFRAG generally agrees with the amended and additional examples in Section C should the proposed amendments to IAS 37 be pursued, but it 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 concerning 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, or (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 interaction of these requirements should be explained in the example. In addition, to be useful for similar but not identical examples, it could be further explained 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: similar to the comments provided on Example 5A, the

interaction 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. Moreover, EFRAG suggests that the example should explain why the penalties related to terminating contracts with customers would be covered by IAS 37 and not IFRS 15.

(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 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. Further, EFRAG questions whether the affected group should be broader than 'factory workers'. Also, the reference in relation to the transfer condition 'in buying and fitting the filters, the entity will pay cash and receive property, plant and equipment in exchange' could include a cross reference to paragraph 11 of IAS 16 to explain why the smoke filters will result in an asset. As an editorial comment, EFRAG also notes that there should be two different markings in the box of markings related to the past event condition (similar to what is done for the transfer condition).

(e) Example 7 – Retaining staff as a result of changes in the income tax system: EFRAG suggests specifying whether the training is required for compliance or business purposes. EFRAG understands, from the assessment of the obligation condition, that the training is for business purposes as it is stated that the entity owes no responsibility for retraining to another party. EFRAG recommends clarifying the point and specifying whether the outcome would be different in case of training required for compliance reasons. Moreover, the example should clearly state that future operating costs should not be accrued (see paragraph 36).

(f) Example 11B – Refurbishment costs: legislative requirement: EFRAG suggests explaining the consequences of failing to overhaul the aircraft in order to illustrate the assessment of the obligation condition. Also, the example could make a cross reference to paragraph 13 of IAS 16 to explain why the overhaul results in an asset (a similar reference could be made in Example 11A).

(g) Example 12 – Liabilities arising from participating in a specific market: waste electrical and electronic equipment: EFRAG recommends that the IASB clarify and specify the term 'no practical ability to avoid' in the Standard, especially in relation to a signed contract, and/or adapt the fact pattern in order to demonstrate the use of the term and thus avoid significant diversity in practice. EFRAG acknowledges that it will not be possible to provide an exact frame for the situations in which an entity has no practical ability to avoid something; however, examples could illustrate what type of information entities could consider for the assessment and how high/low the bar for such an assessment would be.

(h) 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, it could be useful to specify that in the Accounting Standard itself. Furthermore, EFRAG notes that levies are determined by local jurisdictions and are based on local GAAP. Considering differences that may exist between IFRS Accounting Standards and local GAAP (e.g. levies based on revenue when revenue recognition rules differ between IFRS Accounting Standards and local GAAP), EFRAG suggests that the IASB further clarify the appropriate application of the ED proposals in these situations.

(i) Example 13B – A levy on an entity operating as a bank on the last day of its annual reporting period: The comment made regarding 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. Furthermore, EFRAG requests a more detailed explanation of why, if it would not amend its proposals, the IASB considers that operating within the financial year is the primary relevant action and why an entity is not required to recognise a provision for all anticipated future levies it expects to incur.

(j) Example 13C – A property tax: EFRAG requests that the example clearly articulates why the acquisition of the property or the holding of the property should not be considered as relevant actions.

(k) Example 14 – Negative low-emission vehicle credits: EFRAG recommends that the IASB assess the usefulness of amending the fact pattern with the goal that the elimination of negative credits not be required in 20X0/20X1 but in later years (e.g. 20X4). In addition, EFRAG considers that it could be useful to also illustrate in the example how the provision should be measured.

(l) Example 15 – Climate related commitments: EFRAG notes that the example identifies two obligations: to reduce emissions and to offset the remaining emissions. The example considers both of these obligations for the obligation condition and the transfer condition. However, the obligation to reduce emissions is not considered in relation to the past-event condition. For the sake of consistency, EFRAG recommends that the example also include an assessment of the past-event condition in relation to the obligation to reduce emissions.

Question 7 – Other comments

> **Question 7—Other comments**
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> Do you have comments on any other aspects of the proposals in the Exposure Draft?

EFRAG's response

74 Currently, IFRS Accounting Standards only include guidance on how to account for variable/contingent consideration in some specific cases (e.g. contingent consideration in a business combination). EFRAG considers that the wording of paragraph 14Q of the ED ('in some situations, an entity has an obligation to transfer an economic resource only if it takes two (or more) separate actions …') could be used as guidance on when to recognise a liability for variable/contingent consideration. If this is not the intention, the IASB could indicate so, for example, in the Basis for Conclusions that would accompany amendments to IAS 37.

75 Directly related to the proposals of the ED, EFRAG also recommends to further improve the consistency of the wording of the ED. For example, currently the terms 'probable', 'more likely that not' and 'probable (more likely than not)' seem to be used interchangeably.

As a final comment related to a requirement that is outside of the scope of the ED, EFRAG considers that the disclosure of the timing of provisions (as required by paragraph 85 of IAS 37) should be further assessed for certain cases where such disclosures are not deemed useful, for example in case of portfolios of commitments, where an entity issues guarantees similar to insurance contracts that fall under IAS 37 and court cases, as it is difficult to conclude on whether and when they are payable.