IASB/ED/2024/8 Provisions – Targeted Improvements

Proposed amendments to IAS 37

Exposure Draft issued by the IASB in November 2024

Comments from ACCA
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GENERAL COMMENTS

ACCA welcomes the opportunity to provide views in response to the IASB's exposure draft (ED) for *Provisions – Targeted Improvements*. Our response has been developed with the assistance of ACCA's Global Forum for Corporate Reporting.

Our general comments on the proposed amendments are as follows:

We support updating and aligning the definition of a liability in IAS 37 (the Standard) with the Conceptual Framework (2018) as using a single definition of a liability could reduce complexity for preparers of financial statements, as well as other stakeholders in the corporate reporting environment including auditors, users of financial statements and regulators.

We support using the three conditions – ie 'obligation', 'transfer' and 'past-event' conditions – to assess whether the entity has a present obligation and adding guidance to support the application of these conditions. Our comments in question 1 include some suggestions to enhance the proposed requirements.

We also support

- specifying the types of costs an entity includes in estimating the future expenditure required to settle an obligation and aligning these costs with the measurement of onerous contracts.
- standardising the type of rates an entity uses to discount the expenditure to settle an obligation, ie a risk-free rate with no adjustment for non-performance risk.
- replacing the decision tree in Section B of the *Guidance on implementing IAS 37.* The new decision trees (B1 – B3) are clear and helpful in guiding entities to determine whether a provision needs to be recognised.
- amending and adding new examples in Section C of the *Guidance on implementing IAS 37.* The amended and new examples in this ED are helpful as they demonstrate the application of a particular requirement in the Standard. Our comments in question 6 include suggestions to improve individual examples.

The proposed modified retrospective approaches to apply the amended requirements are pragmatic. After the amended requirements are issued, we suggest allowing entities at least two years to understand the effects of the amended requirements and make the necessary preparations before the amended requirements become effective. Entities would need time to assess whether there are provisions that have yet to be recognised in accordance with the amended requirements and whether there would be changes to the amounts of provisions already recognised.

Our detailed responses to the specific questions asked and suggestions for improvements are set out below.

RESPONSES TO SPECIFIC QUESTIONS RAISED

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?

ACCA response

Definition of a liability

We support updating the definition of a liability[1] in IAS 37 to align with the definition in the Conceptual Framework (2018) and other minor consequential amendments to various other paragraphs in IAS 37 that include words or phrases from that definition[2]. We concur with the IASB's view that using a single definition of a liability could reduce complexity for preparers of financial statements[3], as well as other stakeholders including auditors, users of financial statements and regulators.

Aligning the wording of the present obligation recognition criterion with the updated definition of a liability

We support replacing the obligating event condition[4] with the three distinct conditions for a liability to exist – ie the 'obligation', 'transfer' and 'past-event' conditions[5].

[1] Paragraph 10 of IAS 37 in this ED.
[2] Paragraphs listed in Appendix A of this ED.
[3] Paragraph BC23 of this ED.
[4] Paragraph 17 of the extant IAS 37.
[5] Paragraph 4.27 of the Conceptual Framework (2018).

Requirements supporting the obligation condition
We support clarifying the circumstances in which an entity has no practical ability to avoid discharging a responsibility[6], but we suggest enhancing paragraphs 14F(a)(ii) and 14F(b), as follows:

Paragraphs 14F(a)(ii)
The phrase *'the economic consequences for the entity of not discharging the responsibility are expected to be significantly worse than the costs of discharging it'* will be difficult to apply to in practice. For example, an entity that has an obligation to decommission and dismantle a plant twenty years later will find it difficult to assess whether the economic consequences of not decommissioning and dismantling the plant will be worse than doing so. The term 'economic consequence' is not defined and will be subjected to interpretations. Also, it will be difficult to assess to what extent an economic consequence needs to be unfavourable (negative) to be deemed 'significantly worse'. Related to this, the IASB had noted application difficulties in IAS 39 in assessing whether a decline in the fair value of an available-for-sale equity instrument was *'significant or prolonged'* and recently when updating the requirements to assess whether an investment in an associate is impaired[7]. We believe a legal obligation should already exist when the economic consequences of not discharging the responsibility are expected to be more than the costs of discharging it, ie the entity is worse off. Therefore, we suggest the IASB simplify this requirement to avoid introducing potential application difficulties and prevent diversity in practice.

Paragraphs 14F(b)
We are not convinced that creating valid expectations in other parties that the entity will discharge a responsibility, by itself, would stop the entity from changing its practice, policy or statements, as the expectations are not legally binding. Further, the IASB explained that having an established pattern of past practice, publishing a policy or making a statement is not in itself sufficient to create a present constructive obligation for an entity[8]. The entity would still be able to avoid discharging the responsibility. We suggest the IASB enhances the requirement for what constitute *'no practical ability to avoid discharging a responsibility'* in the context of a constructive obligation[9].

Requirements supporting the transfer condition
We support adding requirements to support the application of the transfer condition[10]. The following proposed additions to the Standard are helpful:
- Explanation that only a low threshold is required to establish the existence of a potential to transfer an economic resource[11]
- Clarification that the probability of transferring an economic resource condition does not influence the existence of an obligation, but affects whether a liability

[6] Paragraphs 14B and 14F of IAS 37 in this ED.
[7] Paragraphs BC100 – BC103 of the Exposure Draft: Equity Method of Accounting—IAS 28 Investments in Associates and Joint Ventures (revised 202x).
[8] Paragraph 14T of IAS 37 in this ED.
[9] Paragraph 14F(b) of IAS 37 in this ED.
[10] Paragraphs 14I – 14L of IAS 37 in this ED.
[11] Paragraph 14J of IAS 37 in this ED.

needs to be recognised, or whether a contingent liability needs to be disclosed[12].

- Explanation that the exchange of economic resources with another party is not an obligation to transfer an economic resource to that party unless the terms of the exchange are unfavourable to the entity[13]. We note that several examples in Section C of the *Guidance on implementing IAS 37* demonstrate this principle.

Requirements supporting the past-event condition
The proposed requirements to clarify when the past-event condition is met for threshold-triggered costs is helpful. Clarifying the types of activities that contributes to the total activity on which the cost is assessed is also helpful. However, guidance is required to help entities determine the *'assessment period'*[14] which may be linked to the *'total activity'*. An entity would need to forecast the total activity for the assessment period that is sufficiently reliable to be used in assessing whether the specific threshold will be met[15]. We suggest the IASB provide guidance on determining appropriate *'assessment period'* and to clarify whether the IASB intends for entities to assess periods that are far into the future.

In addition, we suggest the IASB review a portion of paragraph 14P which appears to have overlapped and muddled the recognition and measurement of a provision, ie *'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.'* Stakeholders informed us they are confused by this portion of paragraph 14P. It's unclear whether this portion refers to measuring the metrics that determine whether a threshold has been (or will be) exceeded (and so, an obligation exist), or measuring the provision. We suggest distinguishing between the recognition and measurement of a provision.

We also suggest the IASB clarify in the Standard the interactions between paragraphs 14P and 14Q of this ED, in particular whether:

- one of these paragraphs has a precedence when assessing whether an entity has an obligation, or
- fulfilling either one of these paragraphs would establish the existence of an obligation.

The following proposed additions to the Standard are helpful:

- Clarifying *'when'* a past-event condition is met in situations where an entity needs to take two (or more) separate actions[16]. We note the IASB's rationale for proposing requirements to require entities to accrue a provision progressively instead of recognising it at a point in time[17]. Determining whether an entity has the practical ability to avoid the remaining actions after taking the first action is subject to a high degree of judgement and may vary according to the unique circumstances faced by each entity. Providing application guidance would help entities to determine whether it has *'no practical ability to avoid the remaining actions'*.

[12] Paragraphs 14K(a) and 14K(b) of IAS 37 in this ED.
[13] Paragraph 14L of IAS 37 in this ED.
[14] Paragraph 14P of IAS 37 in this ED.
[15] Paragraph BC46(b) of this ED.
[16] Paragraph 14Q of IAS 37 in this ED.
[17] Paragraph BC35 of this ED.

- Clarifying that the enactment of a new law does not automatically create a present legal obligation for an entity[18], and using an example in paragraph 14U to illustrate this principle.

Consolidating the guidance for recognising a provision and withdrawing IFRIC 6, IFRIC 21 and Agenda Decisions
We note the IASB's intention consolidate the relevant guidance for recognising a provision in one place and the proposed addition of examples in Section C of the *Guidance on implementing IAS 37* that illustrate the fact patterns discussed in IFRIC 6 (Example 12), IFRIC 21 (Examples 13A and 13B), Agenda Decision *Negative Low Emission Vehicle Credits* (Example 14), and Agenda Decision *Climate-related Commitments* (Example 15)[19].

Analysing the accounting treatment of these fact patterns using the amended requirements proposed in this ED would support consistent application of the amended requirements.

We believe withdrawing the interpretations and agenda decisions when the amended requirements and the accompanying *Guidance on implementing IAS 37* are issued would avoid any inconsistencies and placing all relevant guidance in one place would make the guidance more accessible. Therefore, we are supportive of this proposal and we suggest the IASB applies a similar approach when reviewing and updating other IFRS Accounting Standards.

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?

ACCA response
We support the proposal to specify the types of costs an entity includes in estimating the future expenditure required to settle an obligation[20]. We note these costs are aligned with the measurement of onerous contracts[21].

However, the IASB should prohibit recognising future operating costs in a provision, ie retaining paragraph 18 in the extant IAS 37 that the IASB is proposing to delete in this ED.

[18] Paragraph 14S of IAS 37 in this ED.
[19] Paragraphs BC58 and BC59 of this ED.
[20] Paragraph 40A of IAS 37 in this ED.
[21] Paragraph 68A of the extant IAS 37.

An entity may engage the expertise of professionals in various fields to estimate the future expenditure to settle an obligation[22]. We suggest the IASB provide examples of costs that should be included in estimating the future expenditure required to settle an obligation, such as professional fees[23].

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?

ACCA response

Discount rate requirements

We support discounting the cash outflows to settle an obligation to the present value. We also support requiring an entity to use a discount rate that reflects the time value of money – represented by a risk-free rate with no adjustment for non-performance risk[24]. The overarching requirement to measure a provision suggests the entity will settle the obligation[25]. Therefore, excluding any adjustment for non-performance risk is consistent with that requirement. Standardising the type of rate an entity uses is also pragmatic for all stakeholders and we concur with the two factors that the IASB considered when deciding to exclude the adjustment for non-performance[26].

As the IASB had noted in the *Exposure Draft: Business Combinations—Disclosures, Goodwill and Impairment*, determining pre-tax discount rates is costly and complex. A pre-tax discount rate is also hard to understand and is not observable[27].

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[22] Paragraph 38 of the extant IAS 37 suggests the estimates of outcome and financial effect may be supplemented by reports from independent experts.
[23] For example, paragraph 17 of IAS 16 provides a list of examples of directly attributable costs for an item of property, plant and equipment.
[24] Paragraphs 47 and 47A of IAS 37 in this ED.
[25] Paragraph 36 of the extant IAS 37 (unchanged by this ED) states: *'The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period'*.
[26] Paragraphs BC78(a) and BC78(b) of this ED.
[27] Paragraph BC217 of the ED: Business Combinations—Disclosures, Goodwill and Impairment.

For this ED, the IASB observed that entities typically determine an appropriate risk-free rate by reference to an observable market proxy for a risk-free rate, and in some cases, an entity might adjust that observable market proxy to compensate for differences between the duration and liquidity of the investment and those of the provision[28]. Requiring entities to adjust the observable market proxy to become a pre-tax rate would complicate the measurement of a provision. We suggest the IASB simplify the measurement approach by removing the requirement to use a pre-tax rate and instead, require entities to use internally consistent assumptions for cash flows and discount rates.[29] This approach should provide useful information to users at a lower cost, compared to specifying using a pre-tax rate.

Disclosure requirements
This simpler approach should be complemented by the entity disclosing the discount rate used in measuring the provision and the approach used to determine that rate. Accordingly, we support the proposed disclosure requirement[30].

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?

ACCA response

Transition requirements
We support the pragmatic modified retrospective approaches that are proposed in paragraphs 94B – 94E of this ED.

[28] Paragraph BC82 of this ED.
[29] Though changing the pre-tax rate requirement is not within the scope of this ED, our suggestion aims to align the calculation of present value in IAS 37 with IFRS 13, in particular paragraph B14(d) of IFRS 13 which requires using internally consistent assumptions about cash flows and discount rates in calculating present value.
[30] Paragraph 85(d) of IAS 37 in this ED.

Effective date
Entities would need time to assess whether new provisions may need to be recognised as a result of the amended requirements and whether any changes need to be made to the amounts of provisions already recognised. Some of these cashflows would take place in the distant future. At the very least, the amended requirements would result in entities:

- assessing the existence of new obligations that may arise from the entity's strategy and/or changes to business model to manage its climate and other sustainability-related risks and opportunities.
- reassessing the assessment period and total activity for threshold-triggered costs.
- recognising provision progressively over time instead of at a point in time.
- reassessing and adjusting the discount rate(s) used, including the removal of non-performance risk from the discount rate[31].
- gathering data to reassess the assumptions used and to update the models used for estimating the future expenditure to settle the obligations.
- adjusting the carrying amounts of related assets that correspond to the changes in amounts of provisions.
- gathering data for comparative information.

Therefore, we suggest the IASB allow at least two years from the date the amended requirements are issued before the requirements become effective. This would provide entities sufficient time to understand the effects of the amended requirements and make the necessary preparations.

We support permitting earlier application of the amended requirements and requiring entities that do so to disclose that fact. This would benefit entities that are able and willing to apply the amended requirements earlier.

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?

ACCA response
We support the proposed disclosure of the discount rate used in measuring a provision[32]. We concur with the IASB's rationale for exempting eligible subsidiaries to

[31] Paragraph BC94 of this ED.
[32] Paragraph 258(d) of IFRS 19 in this ED (Appendix B).

disclose the approach used to determine the discount rate used in measuring a provision[33].

In relation to effective date, we suggest the IASB add a requirement for eligible subsidiaries that apply the amended requirements in IAS 37 earlier than the effective date to disclose that fact[34].

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?

ACCA response

Section B: Decision tree
The decision trees (B1 – B3) are clear and helpful in guiding entities to determine whether a provision needs to be recognised[35].

We are supportive of giving more prominence (in B2 and B3) to the consequence of an obligation failing to meet the present obligation recognition criterion – namely the entity has neither a provision nor a contingent liability – could help avoid any misunderstanding that an obligation that fails any of the criteria for recognising a provision is a contingent liability[36].

Section C: Examples
Demonstrating the analysis for the three conditions supporting the application of the present obligation recognition criterion – ie the 'obligation', 'transfer' and 'past-event' conditions – in each example helps entities to understand the necessary assessment when applying these three conditions to determine whether the present obligation recognition criterion is met. The amended and new examples in this ED are helpful as they demonstrate the application of a particular requirement in the Standard.

[33] Paragraphs BC104 and BC105 of this ED.
[34] Paragraph A6 of IFRS 19 in this ED (Appendix B).
[35] Section B of the Guidance on implementing IAS 37 in this ED.
[36] Paragraph BC57 of this ED.

However, we suggest adding an example that illustrates the assessment of a threshold-based obligation by applying the requirements proposed in paragraph 14P of this ED. This example should help address practice questions about when to recognise provisions for threshold-triggered costs.

The following features in the examples are also helpful:

Distinguishing an obligation to exchange economic resources and an obligation to transfer economic resources
Examples 6 (fitting smoke filters), 7 (contract with training provider) and 11B (aircraft overhaul) provide helpful guidance to support consistent application of the transfer condition by demonstrating the difference between an obligation to exchange economic resources and an obligation to transfer an economic resource and thus distinguishing when each type of liability will be recognised.

Distinguishing an obligation owed to another party and performing an action for own benefit
Examples 7 (quality of service) and 11A (furnace lining) provide helpful guidance to entities to determine whether a particular action meets the obligation condition.

Determining when the obligation condition is met when two or more actions are required
Examples 13A, 13B and 13C provide helpful guidance to entities when assessing whether and when two or more actions have met the obligation condition. Example 13A is helpful in illustrating the measurement of a provision that will vary based on a specific benchmark, ie the entity's revenue.

Improvements to individual examples in Section C
We would like to suggest some improvements to enhance the usefulness of several examples. Our suggestions for individual examples are set out below:

Example 3
Based on the fact pattern, 10% of the total costs for removing the oil rig and restoring damaged seabed would only be incurred by the entity as a consequence of extracting oil. What remains unclear is the pattern of recognition for the liability relating to extraction of oil, such as whether the liability will be front-loaded when the extracting of oil begins or recognised based on amount of oil extracted or evenly over time. We suggest extending the example to demonstrate the recognition of the provision progressively over time as the entity extracts the oil.

Example 13C
We suggest illustrating the rationale that the entity has no practical ability to avoid paying the tax on the land and buildings it owns and holds for business use on 31 December 20X5. Both Examples 13B and 13C explained the rationale, ie the economic consequences for the entity of exiting the market (or ceasing banking activities) before a certain date would be significantly worse than the cost of paying the levy.

Example 14

Based on the fact pattern, the positive credits are generated as a byproduct of manufacturing cars, and management expects the entity to generate the positive credits itself (thus avoiding the need to buy positive credits) by manufacturing cars with average fuel emissions lower than the government target in 20X1.

The conclusion proposed for this example appears to suggest that in 20X0, the entity accrue for the costs to manufacture cars in 20X1 to the extent of generating sufficient positive credits to offset the negative credits that it received in 20X0. This proposed conclusion presents several problems:

- The entity would be accruing for the costs to manufacture cars rather than the cost of the positive credits. There is no basis for an entity to accrue for the costs of its products ahead of incurring the expenditure. Accordingly, we disagree with removing paragraph 18 in the extant IAS 37 that prohibits recognising future operating costs in a provision.[37]
- The treatment for the debit entry created by this provision is unclear.[38] Given the entity manufacture and sells cars, one may expect the corresponding debit entry to be inventories.

To avoid further confusion, we suggest the IASB amends this example to

- separate the costs for generating the positive credits from the overall costs to manufacture a car, or
- illustrate the market price for positive credits, and
- amend the conclusion for this example.

Example 15

Analysis of the *transfer condition* in this example appears to contradict the analysis of the transfer condition in Example 14 that describes the positive credits as economic resources. When purchasing carbon credits, the entity is exchanging one form of economic resources (eg cash) with carbon credits (another form of economic resource) that can be used to offset the entity's emissions. The entity would otherwise need to incur other costs to reduce its emissions. Therefore, it would be incorrect to say the entity is not receiving any economic resources when it is buying and then retiring carbon credits. We suggest the IASB review and amend the analysis as appropriate.

[37] Paragraph 18 of the extant IAS 37 states, '[…] no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an entity's statement of financial position are those that exist at the end of the reporting period'.

[38] The IASB should consider a holistic approach to address this issue in its pollutant pricing mechanisms project.

QUESTION 7 – OTHER COMMENTS

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

ACCA response

IFRS 3 requires all identifiable assets and liabilities of the acquiree to be measured at their acquisition-date fair values.[39] The difference in measurement approach between IFRS 3 and the approach proposed in this ED could result in a Day 2 adjustment to the provision, which also affects the profit or loss. We suggest the IASB consider providing an exception to the recognition and measurement principles in IFRS 3 for provisions assumed in a business combination.

[39] Paragraph 18 of IFRS 3.