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Andreas Barckow
Chair
International Accounting Standards Board
Columbus Building
7 Westferry Circus
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Dear Dr Barckow

Exposure Draft *Provisions—Targeted Improvements (Proposed amendments to IAS 37)*

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's Exposure Draft *Provisions—Targeted Improvements (Proposed amendments to IAS 37)*.

We agree with the high-level objective explained in ED 37:BC23 to update the definition of a liability in IAS 37 to align it with the Conceptual Framework aimed at reducing complexity through use of a single definition of liability throughout IFRS Accounting Standards. However, such a change will only be beneficial if the high level principles in the Conceptual Framework can be explained clearly and are capable of consistent application in the context of provisions.

We do not believe that the proposals achieve this. We are concerned that, if finalised in their current form, the proposals would be difficult to apply and/or may not provide relevant outcomes. This is why we believe that it is imperative that before finalising the proposals the IASB conducts wide outreach to test the proposals against a large variety of obligations to which IAS 37 applies, including the new mechanisms used to encourage changes in the way entities operate (e.g. climate-related regulations) or to tax entities.

We also believe that the IASB should reconsider the conclusion reached when amending the Conceptual Framework that it is not necessary to develop specific guidance to explain how the definition of liability applies to non-reciprocal transactions. We believe that non-exchange transactions such as taxes and levies imposed by statute and other similar enforceable legal provisions constitute a separate class of transactions. In particular, we believe that the 'past event' necessary to the recognition of a provision for a tax or levy deserves separate guidance. Whilst the ED presents a single set of guidance to identify the past event(s) for all transactions in the scope of IAS 37, certain of the paragraphs proposed (namely ED 37:14P and 14Q) appear to introduce rules to accommodate the non-reciprocal nature of levies and taxes. As the application of these paragraphs is not circumscribed to such transactions, we are concerned that the apparent conflict with the general principles set out elsewhere (e.g. ED 37:14N) and the lack of clarity on their application to reciprocal transactions will give rise to diversity in practice. We expand on these concerns in our detailed comments.

Whilst we agree with the proposals to specify that the measurement of provisions includes an allocation of costs directly related to settling the obligation and that the discount rate excludes non-performance risk, we strongly believe that the objective of reducing diversity in practice will not be achieved unless further guidance is provided in respect of these proposals.

If you have any questions concerning our response, please contact Veronica Poole in London at +44 (0)20 7007 0884.

Yours sincerely

Veronica Poole
Deloitte Global IFRS and Corporate Reporting Leader

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Appendix – Responses to the specific questions on the proposals in the Exposure Draft

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 ED 37:BC3–BC54 and ED 37: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?

We agree with the high-level objective explained in ED 37:BC23 to update the definition of a liability in IAS 37 to align it with the Conceptual Framework aimed at reducing complexity through use of a single definition of liability throughout IFRS Accounting Standards. However, such a change will only be beneficial if the high level principles in the Conceptual Framework can be explained clearly and are capable of consistent application in the context of provisions. This is important because IAS 37 applies to a broad range of obligations, including new mechanisms used to encourage changes in the way entities operate (e.g. climate-related regulations) or to tax entities. Clarity is necessary to ensure that entities can determine how to apply the requirements to their own facts and circumstances, and to reduce the likelihood of diversity in practice.

As explained below, we do not believe that the proposals provide sufficiently clear guidance and are concerned that, if finalised in their current form, the proposals would be difficult to apply and/or may not provide relevant outcomes. This is why we believe that it is imperative that before finalising proposals the IASB conducts wide outreach to test the proposals against a large variety of obligations to which IAS 37 applies.

We also believe that the IASB should reconsider the conclusion reached when amending the Conceptual Framework that it is not necessary to develop specific guidance to explain how the definition of liability applies to non-reciprocal transactions. We believe that non-exchange transactions such as taxes and levies imposed by statute and other similar enforceable legal provisions constitute a separate class of transactions. In particular, we believe that the 'past event' necessary to the recognition of a provision for a tax or levy deserves separate guidance. Whilst the ED presents a single set of guidance to identify the past event(s) for all transactions in the scope of IAS 37, certain of the paragraphs proposed (namely ED 37:14P and 14Q) appear to introduce rules to accommodate the non-reciprocal nature of levies and taxes. As the application of these paragraphs is not circumscribed to such transactions, we are concerned that the apparent conflict with the general principles set out elsewhere (e.g. ED 37:14N) and the lack of clarity on their application to reciprocal transactions will give rise to diversity in practice.

Our specific concerns in respect of the amendments to the definition of liability are as follows.

Obligation condition

We support the IASB's objective of disentangling the 'obligation condition' and the 'past-event condition'. The confusion between the two is a source of difficulties in practice as evidenced by the recent IFRIC agenda decisions (e.g. the agenda decisions on negative low emission vehicle credits and on climate-related commitments). However, we are concerned that some of the proposed guidance on the obligation condition is not as clear as it could be.

Our key concern relates to the explanation provided in ED 37:14F of what it means for an entity to have no practical ability to avoid discharging a responsibility. We understand from the discussion in ED 37:BC20 that it is meant to be the same as "having no realistic alternative to settling that obligation" currently used in IAS 37. If this is the case, we believe that the existing wording from IAS 37 should be retained.

Further, we note that the ED 37:BC29 explains that in the context of assessing the obligation condition the 'practical ability to avoid' relates to whether an entity can avoid settling an obligation that *has been* created. However, the wording in ED IAS 37:14F is not clear in that respect:

- In the context of legal obligations, the explanation of the practical ability to avoid discharging the responsibility in ED 37:14F(a) covers (i) the existence of an enforceable mechanism (i.e. whether an obligation has been created) and (ii) the consequences of not discharging the obligation. By covering both aspects, ED 37:14F(a) does not convey that the 'practical ability to avoid' in this context is about the entity's ability to circumvent an obligation that exists, which appears to be addressed specifically in ED 37:14F(a)(ii). Further, the assessment of whether an entity has the practical ability to avoid settling an obligation in ED 37:14F(a)(ii) refers to economic consequences that are significantly worse than settlement of the obligation. This wording does not convey the same meaning as having no realistic alternative to settling the obligation. It also seems to imply a lower threshold than the examples of liquidation and ceasing to trade in CF 4:33. In fact, the wording in ED 37:14F(a)(ii) could reasonably be read as an economic compulsion assessment. We understand that this is not the intent and strongly encourage the IASB to reconsider the explanation provided in ED 37:14F(a). The explanation in CF:BC4.55 that the practical ability "is intended to mean not just that it would be economically advantageous to make the transfer. Rather, the adverse economic consequences of not making the transfer are so severe that the entity has no practical ability to avoid the transfer" would be a useful addition to the standard.
- In the context of constructive obligations, the explanation in ED 37:14F(b) appears to relate to circumstances that give rise to a constructive obligation (i.e. the fact that the entity by its actions has created a valid expectation that it will discharge an obligation) and not whether the entity can then avoid settling its constructive obligation. We believe that the statement is valid but should be presented as an explanation of ED 37:14C(b), which explains when a constructive obligation arises. We believe that if an entity has taken the actions described in ED 37:14C(b) and ED 37:14F(b) to establish a constructive obligation, the obligation condition is met and a provision should be recognised. In effect, the concept of 'practical ability to avoid' settlement does not apply to constructive obligations.

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Transfer condition

We understand from ED 37:14L that the key purpose of the transfer condition is to prevent the recognition of provisions in respect of executory contracts, except if they are onerous. We agree that this is appropriate.

We note that ED 37:3 defines an executory contract as "a contract, or a portion of a contract, that is equally unperformed". Whilst we agree that in some circumstances it is necessary to break a contract into portions, we note that IAS 37 does not include any guidance to assess when this is the case. We believe that it would be important for such guidance to be provided, in particular to ensure that onerous contracts are appropriately recognised and measured. The IASB may want to consider whether the guidance in IFRS 15 on identifying performance obligations could be used as a basis.

We also note that ED 37:14J indicates that the transfer condition is met when the obligation has the "potential to require the entity to transfer an economic resource to another party". Some obligations, for example asset retirement obligations, may require an entity to restore the land in a way that benefits the relevant community (e.g. build a park). In such cases, the economic resource is transferred to society at large. Accordingly, we believe that it would be useful to specify that the transfer condition may be met even though the entity does not know the identity of the recipient of the economic resource, using an explanation similar to the explanation provided in ED 37:14D in the context of the obligation condition.

Our key concern on the transfer condition relates to how it is explained in the illustrative examples. We believe that it is important to distinguish the *transfer* required to settle an obligation from the *exchange* transaction that an entity may decide to enter into in order to obtain the goods or services required to settle that obligation. For example, an entity with a land rehabilitation obligation may expect to hire a third party to perform the rehabilitation work. The settlement of the land rehabilitation involves a transfer (i.e. a net outflow) even though a contract for rehabilitation work is an exchange transaction. It may be useful to add this further explanation in illustrative examples 2 and 3.

Furthermore, some of the illustrative examples (in particular Examples 6, 7 and 11) relate to situations that impose actions on the entity (training of employees or refitting/refurbishment of items of property, plant and equipment) that the entity will satisfy by entering into an exchange transaction. The examples conclude that the transfer condition is not met because the entity has not yet entered into the exchange transaction. However, it is important to explain why in these examples, in contrast to Examples 2 and 3, the fact that the entity is required to take a certain action does not embody a transfer (regardless of whether the obligation is satisfied by entering into an exchange transaction).

Past-event condition

Our key concerns about the requirements proposed in respect of the past-event condition relate to ED 37:14P and 14Q that appear to be included to deal specifically with the scenarios currently addressed in IFRIC 21. We note that the application of these paragraphs is only invoked in the illustrative examples in the context of levies. We acknowledge the criticisms raised of the accounting resulting from the application of IFRIC 21. However, IFRIC 21 reflects clear principles on the identification of the past event supporting the recognition of a liability. We believe that these principles were consistent with those in IAS 37. We are concerned that the guidance proposed in ED 37:14P and 14Q does not have the same level of clarity. These paragraphs appear to have been drafted specifically to achieve recognition over time of the obligation resulting from a levy whereas IFRIC 21 required recognition at a point in time. This is further reinforced by the fact that the only illustrative examples for which the conclusion on the timing of recognition is affected by the amendments are those that come from IFRIC 21.

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When an obligation arises from an exchange transaction, the past event is generally easy to identify and the requirements in ED 37:14M-14O appear to be clear. However, ED 37:14P and 14Q will give rise to difficulties in practice, when identifying whether an obligation that accumulates over time (or includes a threshold) arises from one on-going action or from a combination of actions. For example, illustrative example 11B addresses an airline required by law to overhaul its aircraft once every three years. The example identifies the past event as operating an aircraft that has not been overhauled for more than three years and concludes that, as this action has not yet taken place, no provision should be recognised. This conclusion reasonably follows from application of the requirements in ED 37:14N. Similarly, where, the regulation imposes an obligation on an airline to overhaul its aircraft after a specified number of flight-hours it would be reasonable to conclude, inferring from the example, that the past event is operating an aircraft that has not been overhauled for more than the specified number of flight-hours and no provision should be recognised if this action has not yet taken place. However, ED 37:14P and 14Q, would imply that the obligation is a combination of a first action, i.e. operating the aircraft over time, and a second action, i.e. continuing to operate the aircraft once the specified number of hours have been flown (resulting in the need to incur the costs of an overhaul or the penalties imposed under the regulation), which would lead to recognition of the obligation over time rather than at a point in time.

In addition, it is not clear that ED 37:14P and 14Q will provide relevant guidance in addressing difficulties in the application of IAS 37 in respect of reciprocal transactions. A key difficulty currently encountered in practice relates to the recognition of transactions involving variable payments (e.g., the acquisition of an item of property, plant and equipment or an intangible asset in exchange for variable consideration based on sales generated from use of the asset). However, it is not clear whether the IASB intends for the requirements in ED 37:14P to apply to such transactions (e.g. the first action is the acquisition of the intangible asset and the second action is the generation of sales) or whether the IASB considers that these transactions are outside the scope of IAS 37. We believe that this should be clarified.

In light of the concerns noted above, unless the IASB identifies, through its outreach, difficulties or diversity in practice related to reciprocal transactions that are best addressed through application of principles set out in ED 37:14P and 14Q we strongly suggest that these paragraphs should be ringfenced, for example through introduction of a specific section, to non-exchange transactions such as taxes and levies. Furthermore, we suggest that the IASB should consider the scope of non-reciprocal transactions to which these paragraphs should apply, in particular whether they also apply to the recognition of commitments to make donations that may extend over more than one reporting period.

If paragraphs ED 37:14P and 14Q are retained we believe that the following aspects need to be considered.

Definition of the past event when an obligation arises only if a measure of an entity's activity exceeds a threshold

A key difficulty that is likely to arise from ED 37:14P is that it introduces a rule that defines the past event in a manner that does not appear consistent with the requirements in ED 37:14N.

ED 37:14N explains that an entity has an obligation when it has taken *a specific action* as a consequence of which it will or may have to transfer an economic resource that it would not otherwise have had to transfer. When a levy is due if an entity's revenues exceed a specified threshold, a reasonable application of the requirement in ED 37:14N is that the specific action that results in the obligation to pay the levy is the generation of revenue in excess of the threshold. However, in such a case, ED 37:14P defines instead the past event as any action that contributes to the total activity on *which the amount of the transfer* is defined. Put otherwise, in this case, the past event is determined by reference to the measurement of the levy and not the action that triggers the levy to become due. ED 37:14P is not presented as a rule or an exception to the general requirement in IAS 37 and would therefore reasonably appear to be applicable broadly. This apparent conflict will undermine coherency of the principles and lead to diversity in practice.

If the IASB believes that specific rules in ED 37:14P and 14Q are required in respect of certain taxes and levies, the rules should ringfenced through presentation in a separate section and the scope of their application clearly defined. In particular, it would be important to clarify the nature of actions that are relevant in applying ED 37:14P. For example, is it limited to actions related to an entity's performance (such as generation of revenue) or does it extend in certain circumstances to actions related to an entity's financial position (such as ownership of certain assets). It would also be important to address the application to schemes where the amount due by an entity is determined based on the entity's own activity and an overall industry measure (e.g., obligations under the CORSIA scheme).

Obligations triggered by two or more separate actions

ED 37:14Q also appears to introduce a rule, not fully consistent with the requirements in ED 37:14N.The requirement in ED 37:14Q departs from the requirement ED 37:14N, as it dictates that the past-event condition is met if the first action has been taken and the entity has no practical ability to avoid taking the second one. In effect, applying ED 37:14Q, the past event condition is met even though the entity has not yet taken the action as a result of which it will or may have to transfer an economic resource that it would not otherwise have had to transfer (which is the second action). As noted above, if the IASB believes that specific rules are required in respect of certain non-reciprocal transactions, the rules should be presented as such and the scope of their application clearly defined.

If the IASB retains paragraph ED 37:14Q, it would be important to clarify the difference between the concept of 'practical ability to avoid' used in the obligation and the past-event conditions. The factors used to assess whether an entity has the 'practical ability to avoid' taking a future action should also be explained. As proposed in the ED it appears that a higher threshold is set to assess the 'practical ability to avoid' in the context of assessing the past-event condition. Indeed, ED 37:14R refers to liquidation or ceasing to trade. However, illustrative example 13A concludes that the entity does not have the practical ability to avoid taking the second action (operating on the market in a subsequent period) because "the economic consequences for the entity of exiting the market before 20X1 would be significantly worse than the cost of paying the levy", i.e. based on a comparative assessment of the consequence of taking or not the second action. As noted above, we believe that it would be inappropriate to use the 'practical ability to avoid' concept to introduce economic compulsion as a basis to recognise liabilities.

Finally, we believe that it would be important to provide further guidance on how to assess whether an obligation relates to one on-going action or to two (or more) separate actions. We agree with the observation in ED 37:BC36 that, in practice, the ultimate assessment would depend on specific facts and circumstances. However, implementation guidance is necessary to ensure that similar facts and circumstances are assessed consistently. Unfortunately, the proposed illustrative examples 13B and 13C do not bring sufficient clarity as we explain further in our response to Question 6.

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 ED 37: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?

We agree that the expenditure required to settle an obligation should comprise the costs that relate directly to the obligation. This appears most consistent with the principle that a provision should be measured at the amount an entity would rationally pay to settle the obligation or to transfer it to a third party, which would likely include a compensation for the directly related costs associated with the obligation. In addition, in respect of an onerous contract obligation, the proposals ensure that the costs reflected in the measurement of the obligation are the same as those used to determine whether the contract is onerous.

Whilst the IASB decided not to provide further guidance on the costs that relate directly to a contract as part of the onerous contracts amendments, we believe that it is important that such guidance be provided as part of these latest amendments because they will apply to a much broader population of obligations including some that may be very material to an entity's financial position (e.g. rehabilitation provisions in the mining and oil and gas sectors). Without guidance, diversity in practice is likely to persist. We note that other IFRS Accounting Standards (e.g. IAS 16) specify the costs to be included in the measurement of an item. We believe the same is possible in the context of IAS 37. We suggest that a key part of the guidance would be differentiating the costs directly related to the obligation from future operating losses (addressed in IAS 37:63).

As part of the development of this additional guidance, we believe that it would be useful to specify when legal costs, internal and external, should be reflected in the measurement of provisions. At present, difficulties arise in practice in assessing whether these costs should be reflected in the measurement of the obligation (e.g., because the related legal advice may help reduce the costs that would otherwise be incurred) or are related to an executory contract and therefore should not be recognised until the legal services have been received.

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 ED 37: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?

<u>Proposed discount rate requirements</u>

As noted in ED 37:BC75-BC77, there are conceptual grounds for either including or excluding performance risk from the discount rate used to measure provisions. We believe that specifying that the discount rate should exclude non-performance risk is appropriate to reduce diversity in practice.

However, in order to achieve the objective of reducing diversity in practice, we believe that further guidance is required to assist entities in determining a reasonable approach to estimate the discount rate. We believe that it would be appropriate to specify that the risk-free rate is best represented by an overnight borrowing rate. We further suggest specifying that the entity should not be extrapolating future overnight borrowing rates.

We note that ED 37:BC82 indicates various elements that entities may reflect in the risk-free rate, including a currency consistent with that of the provision and the duration of the obligation. The paragraph concludes with a statement that the IASB does not expect all entities to make such adjustments. It is not clear whether this statement represents a general practical accommodation or reflects a reasonable assumption that in some circumstances the impact of these adjustments is not expected to be material (e.g. in respect of provisions expected to be settled in the near future in a low interest rate environment). We therefore believe that the last sentence of ED 37:BC82 should be deleted and replaced with an explanation of when it would be relevant to reflect currency and term in the discount rate.

ED 37:BC68 includes a useful explanation of how an entity may reflect the uncertainty in the amount or timing of the expenditure required to settle a liability either in the cash flows or in the discount rate. We believe that it would be useful to include this explanation in the main standard as it is an issue that often raises questions in practice.

Finally, for completeness, we suggest that ED 37:47A should clarify that non-performance risk should not be reflected in either the discount rate or the estimates of the cash flows.

Proposed disclosure requirements

We agree with the proposed disclosure requirements.

Question 4—Transition requirements and effective date
4(a) Transition requirements The IASB proposes transition requirements for the proposed amendments (paragraphs 94B–94E). Paragraphs ED 37: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?

Transition requirements

We do not support the proposals in ED 37:94D to require specific transition requirements when an entity changes its accounting policy for the costs to include in the measurement of provisions. We acknowledge that these proposals are consistent with those that were included in the onerous contracts amendments. However, unlike those amendments, the proposals in the ED affect more than one aspect of the accounting for provisions. Applying the proposed transition requirements, an entity would recognise the effect of

- Changes in the recognition criteria and the discount rate, at the transition date; and

- Changes in the costs included in the measurement of the provisions, at the date of initial application.

Accordingly, it is possible that, for a given provision, the impact of the amendments may be recognised at different dates. This may give rise to difficulties in application and may not provide the most relevant information. We agree with the IASB's conclusion that it may be difficult and costly to obtain the information required to restate the comparative information to reflect a change in accounting policy for the expenditures included in the measurement of provisions, and that the information is unlikely to be sufficiently useful to justify these costs. In fact, we believe that the same conclusion may apply when an entity is required to recognise a provision not previously recognised. Accordingly, we believe that all changes resulting from the initial application of the amendments should be applied consistently, at the date of initial application.

Similarly, we believe that the difficulties in complying with requirements of IFRIC 1 would not arise solely when an entity is required to change its discount rate. Similar difficulties may arise in respect of newly recognised provisions and changes in the costs included in the measurement of provisions. Accordingly, we believe that the simplified approach proposed in ED 37:94E should be available for all changes resulting from the implementation of the amendments. We believe that this would be consistent with the exception in IFRS 1:D21, which has been used as a basis for the proposed transition requirements.

Effective date

The proposed amendments may have a significant impact on the timing and measurement of provisions, potentially significantly increasing the amount of an entity's liabilities. Entities should be provided sufficient time to assess the potential impact of the amendments, including, for example, compliance with debt covenants. This is a matter that the IASB should consider as part of the extended outreach activities we suggest should be conducted prior to finalisation of the amendments.

In addition, we note that in the extractive industry the measurement of decommissioning obligations is supported by extensive studies that are not necessarily performed annually (e.g. studies performed triennially). As this industry will likely to be affected by the proposed amendments to the measurement requirements, the effective date should provide sufficient time for the required studies to be conducted.

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 ED 37: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?

We agree with these proposals.

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 ED 37: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?

<u>Example 1 - Warranties</u>

In this example, the past event is defined as the sale of defective products, which is assessed as more likely than not on the basis of past experience. However, the illustrative example does not explain clearly why this is the appropriate way of assessing whether the past event has occurred. Accordingly, we suggest that the explanation could be improved by using wording similar to the explanation provided in example 10. For example, the explanation could indicate "[t]he past-event condition is met if the entity has sold defective products. It is unclear whether the entity has done so. Accordingly, paragraphs 15–16 apply. On the basis of the evidence available, management judges it is more likely than not the manufacturer has sold defective products. The past-event condition is met for warranty costs attributable to defective products sold in the past".

<u>Example 2B</u>

The fact pattern indicates that "[m]anagement judges that by publishing the policy and honouring it in the past, the entity has created a valid expectation in society at large that it will honour the policy in the future and therefore has no practical ability to avoid doing so." Consistent with the concerns we raised in respect of the wording of ED 37:14F(b) in response to Question 1, we find that the conclusion that "therefore" the entity has no practical ability to avoid settling its obligation confusing. It appears instead that the sentence explains the basis for concluding that the first two criteria of the obligation condition are met, i.e.

- ED 37:14B(a) is met: there is a mechanism in place to impose a responsibility on the entity if it takes a specific action (i.e. the valid expectation that the entity will honour its published policy as a result of its past practice of doing so, as described in ED 37:14C(b))
- ED 37:14B(b) is met: the entity owes that responsibility to society at large.

As noted in our response to Question 1, we do not believe that the concept of practical ability to avoid settlement is capable of application to constructive obligations. However, if the IASB retains this concept in the context of constructive obligations, consistent with the fact that it is a separate criterion in ED 37:14B(c), we would expect that the conclusion that the criteria is met would require a separate assessment (e.g. management assesses that the entity has no practical ability to act inconsistently with its published policy), rather than resulting from meeting the criteria in ED 37:14B(a) and (b). We believe that it would be important to clarify the example in this respect.

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Examples 5A and 5B

These examples appear to illustrate the accounting for obligations that are within the scope of IAS 19 and IFRS 15, and not within the scope of IAS 37. We suggest that the examples should be modified to reflect the accounting for costs related to a restructuring that are in the scope of IAS 37 (e.g. penalties to terminate a supply agreement).

In addition, it would be useful to have an illustrative example on termination of a supply agreement outside a restructuring transaction to explain whether similar factors would be considered to establish when the provision should be recognised.

Example 7

We suggest that the example could be clarified by addressing separately whether a provision should be recognised for the requirement to provide services to a specified standard and the entity's decision to train employees. As part of the assessment of the obligation condition, it is explained that the entity's responsibility to provide services to a specified standard meets the criteria in ED 37:14B(a). However, no analysis is provided of whether the criteria in ED 37:14B(b) and (c) and the transfer and past-event condition are met in respect of the responsibility to provide services to a specified standard. Instead, the analysis then moves on to address the staff retraining, which is presented as being conducted for the entity's own benefit rather than as a requirement of the new law. We believe that the example should provide an analysis of how the requirements in ED 37:14B(b) and (c) and the transfer and past-event conditions apply in the context of the new law in itself (i.e. the entity's responsibility to provide services to a specified standard).

Example 11B

Whilst we agree with the conclusion reached, we believe that it would be useful to clarify the following elements.

- Nature of the responsibility: the fact pattern describes the scenario as that of an airline that is required by law to overhaul its aircraft once every three years. However, the analysis of the obligation condition describes the obligation as imposing a responsibility on an airline that operates an aircraft that has not been overhauled for three years. We believe that the example would be more useful if it explained why the obligation arises at a point in time (and not overtime). It may be helpful to explain whether the same conclusion would be reached if the overhaul was required after a specified number of hours flown.
- Transfer condition: The transfer condition is explained in terms of the overhaul services received, rather than the responsibility of an airline that operates an aircraft that has not been overhauled for three years (e.g. penalties, grounding or confiscation of the aircraft). We believe this should be clarified to avoid confusion between the obligation and the manner in which the obligation is discharged (e.g. in this case, the least costs of discharging the obligation may be to perform the overhaul).

Example 13B

The levy described in this example is determined based on the measure of an entity's asset at its annual reporting date (prorated if the reporting period is less than 12 months) and is owed only if the entity operates as a bank on that date.

The example identifies the obligation condition as being linked to two actions, operating during the year and operating as a bank on the last date of the year. However, it is not clear from the amendments proposed to IAS 37 why operating during the year is a relevant action in assessing whether an entity has a present obligation. Operating on any days in the year, except for the last day, does not expose the entity to a transfer of economic resources.

We are also concerned by the statement that the levy is a present obligation that accumulates over time as contemplated in ED 37:14O. The entity neither receives benefits nor takes actions during the year that affect its present obligation. The present obligation of the entity remains zero (i.e. it does not accumulate) until the last day of the year.

If this example is retained, significant changes are required to ensure that it provides relevant guidance on the application of the requirements.

Example 13C

We agree with the conclusion that the obligation to pay the levy arises in full on the last day of the year. To provide further clarity on the requirements of the standard, we believe that it would be useful to explain why, contrary to examples 13A and 13B, the levy in example 13C involves only one action that arises at a point in time (e.g., why owning and holding the property at any point in the year is not a separate action).

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

Interaction with IAS 34

We suggest that the IASB should consider how the amendments to the recognition criteria apply in interim financial reports and make relevant amendments to IAS 34.

Interaction with IFRS 3 and IFRS 9

IFRS 3 does not include an exception in respect of the measurement of liabilities in the scope of IAS 37. Accordingly, a provision acquired in a business combination is measured at fair value. As confirmed by IFRS 13 (notably IFRS 13:B36(d) and IE37), the fair value should reflect the non-performance risk relating to the risk that the acquirer will not fulfil the obligation (including the acquirer's own credit risk). As this measurement differs from the proposals in the ED, a loss would result from applying IAS 37 to the provision immediately after the acquisition date. The IASB should address this inconsistency, for example by introducing an exception to the IFRS 3's measurement principles in respect of liabilities in the scope of IAS 37 or specifying the subsequent measurement applicable to such liabilities. If an exception is introduced to the initial measurement principles in IFRS 3, consequential amendments to IFRS 13 will be required.

Similarly, an obligation initially recognised applying IAS 37 may subsequently become a financial liability accounted for applying IFRS 9. It appears that this would trigger a change in measurement to reflect in the carrying amount of the financial liability the entity's own credit risk. We suggest that the IASB should address this inconsistency.

IFRIC Agenda Decisions

Over the years, several agenda decisions were published by the IFRS Interpretation Committee to address issues related to the application of IAS 37. We encourage the IASB to collaborate with the IFRS Interpretation Committee to withdraw in a timely manner the agenda decisions affected by the finalised amendments.