10 March 2025

IASB's Exposure Draft Provisions-Targeted improvements (Proposed amendments to IAS 37)

Response from ICAS

International Accounting Standards Board's Exposure Draft Provisions-Targeted improvements (Proposed amendments to IAS 37)

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General comments

We welcome the opportunity to comment on the International Accounting Standards Board (IASB)'s Exposure Draft *Provisions-Targeted improvements (Proposed amendments to IAS 37)* published on 12 November 2024.

We set out our comments to the consultation questions below.

Consultation questions

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?

Response

It makes sense to align the wording of the recognition criteria with the *Conceptual Framework for Financial Reporting* (CF) and we can see no reason for maintaining the current differences between the CF and IAS 37 in this regard.

However, the extent of the requirements set out in IAS 37.14A to IAS 37.14P introduces a high degree of complexity for accounts preparers and we are concerned that this could have unintended consequences in practice.

Decision-trees can be helpful in applying standards to specific fact patterns, but the complexity of the decision-trees within the proposed implementation guidance would appear to indicate that the proposed changes in IAS 37.14A to IAS 37.14P are overly complex and may give rise to diversity in their application. We suggest that, before the amendments are finalised, additional field testing is carried out to ensure that the accounting outcome of the amendments is as intended.

In addition, the level of commentary on the other recognition criteria is light in comparison and we believe that there is scope to provide further commentary on these. We recommend that the IASB considers providing further commentary on the meaning of the terms 'probable' and 'reliable' as these are intended to be understood [IAS 37.14(b) and (c)]. We believe that the main thrust should set out how accounts preparers should distinguish between the two terms given that the probability of something happening [IAS 37.14(b)] is in itself an estimate; the term 'estimate' being used in IAS 37.14(c) in the context of making a reliable estimate of the amount of the obligation.

We are also mindful that the UK Endorsement Board (UKEB)'s draft comment letter on IAS 37 raises the possibility that the proposed new material on the recognition criteria could create new interpretation issues in relation to:

- The meaning of 'no practical ability to avoid'.
- The introduction of an explicit distinction between a 'transfer' and an 'exchange of economic resources'.

- The application of the proposed amendments to the present obligation recognition criterion to more complex fact patterns, such as certain levies.
- The structure of proposed amendments to the section on ‘Application of the recognition and measurement rules – Restructuring’. The UKEB asks if consideration to be given to disaggregating the material in this section by obligation, transfer and past event.

We are supportive of the UKEB’s analysis and suggestions.

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?

Response

We agree with the proposal that entities should include costs that relate directly to the obligation in estimating the future expenditure required to settle that obligation. This is on the basis that this should reduce the diversity of treatment which exists currently and align the requirements with IAS 37.68A on the measurement of onerous contracts.

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?

Response

We have significant reservations about limiting the selection of a discount rate to a risk-free rate. Therefore, we believe that a requirement to apply a risk-free rate should be accompanied by stronger disclosure requirements than are being proposed.

We believe that additional disclosures are needed to meet the needs of accounts users where a risk-free rate is used, and we provide details about the additional disclosures we would like to see later in our response to this question. Of course, we support the disclosure of discounts rates used and the approach used to determine these.

The proposal that an entity should apply a risk-free discount rate is a simplification and would aid comparability. But a requirement to apply a risk-free discount rate introduces inconsistency with other IFRS Accounting Standards, such as IFRS 16 *Leases* [IFRS 16.26] and IFRS 17 *Insurance contracts* [IFRS 17.32], which require a risk adjusted discount rate to be used, either implicitly or explicitly.

A risk-free rate may not be appropriate to apply to provisions in all circumstances as it may not reflect the true cost of capital/ finance to the reporting entity and, therefore, could result in provisions being overstated and the true risk factors impacting on the business not being reflected in the measurement of its provisions. Additional disclosures could help mitigate the shortcomings of applying a risk-free rate where a risk adjusted rate would be more suitable to an entity's specific circumstances.

We anticipate that some businesses having to move from using a risk-adjusted rate to using a risk-free rate may adjust the cash flow forecasts they use to measure provisions to achieve a best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

To avoid the application of a risk-free rate misleading accounts users, we believe that the following additional disclosures are necessary:

- The methodology used to arrive at the best estimate, i.e. an explanation of the assumptions used to make the estimate, not just the approach taken to determine the interest rate.
- Sensitivity analysis to illustrate the sensitivity of estimates in respect of the discount rate selected and in respect of the estimated lifespan of the provision.

There remains an onus on the IASB to demonstrate, before finalising these amendments, that using a risk-free rate gives investors the most relevant information.

Question 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?

Response

We agree with the proposed transition requirements. Our support is on the basis that these align with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Question 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?

Response

The importance of recognising liabilities where environmental issues are a factor means that there is some urgency attached to the implementation of changes to IAS 37. However, a considerable number of entities may need time to assess the impact of the changes on their going concern status, renegotiate covenants with providers of finance and to source appropriate discount rates.

While we recognise the challenges some entities may experience in gathering the required information to comply with the changes, a long lead time to comply with the revised standard may result in procrastination. Therefore, on balance, we recommend that entities are given 18 months to apply the revised standard.

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

Response

We only agree with the proposals in part. Discount rates require context so that their impact on an entity can be evaluated properly. Therefore, we believe that the requirement to disclose the discount rate without further commentary needs to be conditional on the rationale for selecting the discount rate and a sensitivity analysis being disclosed in the parent entity's group accounts. IAS 37 should likewise be strengthened so that that there is a specific requirement for a subsidiary's rationale for selecting a discount rate to be disclosed and accompanying sensitivity analysis provided. This would mean that where information about a subsidiary's discount rate is material to the group, these disclosures are made in the parent entity's group accounts.

Subsidiary-related disclosures can be lost within group accounts. IFRS 19 accounts, for example, when IFRS 19 is available for adoption in the UK, will still be required to give a true and fair view. This means that if disclosures are material to stakeholders' understanding of a subsidiary's accounts, then they should be included somewhere accessible, for example, on a publicly available website.

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?

Response

Several of the matters we raise in our response to question 1 relating to the recognition criteria also have implications for the content of the Implementation guidance.

We also note that the UK Endorsement Board (UKEB)'s draft comment letter on IAS 37 makes the following comment on the status of the implementation guidance:

"Finally, the IASB should in our view consider whether the examples, currently in the Guidance, should be transferred to the main body of the standard, as application guidance that is an integral part of the standard. We expect the Guidance to be relied on heavily by preparers and auditors and, in effect, to take on the weight of authoritative requirements. Including them as an integral part of the standard, as application guidance, would give them an appropriate level of prominence and authoritative status. Other IFRS Accounting Standards, such as IFRS 9 *Financial instruments*, provide precedents for such an approach."

We would also welcome consideration being given by the IASB as to whether the Implementation guidance should acquire the status of application guidance, in view of existing precedents for this approach. However, this is dependent on resolving the concerns we raise elsewhere in our response, in particular in our response to question 1.

Question 7 – Other comments

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

Response

The proposals would benefit, as we have referred to in our responses to other questions, from the further strengthening of disclosures about the underlying assumptions used to estimate provisions, particularly in the event that reporting entities are required to apply a risk-free discount rate.

Also, with developments in sustainability reporting and the emergence of different sustainability reporting requirements internationally, how will the proposed and eventual changes to IAS 37 dovetail with these? For example, how will they dovetail with transition plan requirements and with sustainability disclosure requirements, including the requirement to publish climate-related scenarios, applicable in different jurisdictions?

Entities reporting under IFRS Accounting Standards, including EU and UK-adopted IFRS Accounting Standards, have different sustainability reporting requirements and some such entities will be expected to apply sustainability reporting standards, but not necessarily the same standards. While it would make sense for the IASB to consider any interaction between IAS 37 and IFRS Sustainability Disclosure Standards, issued by the ISSB as these fall within the remit of the IFRS Foundation, the reality is much more complex and is evolving. For example, how will this work for companies applying EU-adopted IFRS Accounting Standards to their financial statements and the European Union's European Sustainability Reporting Standards (ESRSs) to their sustainability disclosures, and for Non-EU companies caught by the Corporate Sustainability Reporting Directive (CSRD)?

These questions need to be considered in finalising amendments to IAS 37.

While acknowledging the relative flexibility, newness and evolving nature of sustainability disclosure frameworks, for clarity, understanding and a fair presentation, where relevant, the same costs, timeframes, discount rates, boundaries etc should be used for sustainability purposes as used in financial statement disclosures (when appropriate definitions are triggered).

It is important that financial and sustainability disclosures are consistent and make sense when read together. It may be appropriate to consider including, in guidance if not the standard, an adapted corollary paragraph to the following paragraph from IFRS Sustainability Disclosure Standard 1 (S1):

“Data and assumptions used in preparing the sustainability-related financial disclosures shall be consistent – to the extent possible considering the requirements of IFRS Accounting Standards or other applicable GAAP – with the corresponding data and assumptions used in preparing the related financial statements” [IFRS S1.23]

Reporting entities must appropriately report their sustainability targets, claims and activities, otherwise directors are exposing the entity to an increased risk of litigation.

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