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10 March 2025

Dear Sir

Exposure Draft ED/2024/8: Provisions – Targeted Improvements (Proposed amendments to IAS 37)

We are pleased to comment on the above Exposure Draft (the ED). Following consultation with the BDO network[1], this letter summarises views of member firms that provided comments on the ED.

We support the objective of the IASB to clarify the application of IAS 37, including the elimination of longstanding application questions such as how the discount rate used to measure provisions should be determined. While we do not object to the outcomes produced by applying the revised recognition criteria proposed in the ED, we are concerned about:

1) The high level of complexity required to interpret and apply the recognition criteria for provisions (22 paragraphs in IAS 37 and three separate flowcharts in the implementation guidance); and

2) The potential for inconsistent application to different types of levies and unintended consequences as a result of the complexity of the proposals in comparison to consistent application that has been achieved applying IFRIC 21.

To address these concerns, we suggest that the IASB consider whether the requirements may be simplified, including more clearly differentiating between recognition criteria and measurement requirements (e.g. proposed paragraph IAS 37.14P).

Additionally, we suggest that the IASB perform additional field testing on the proposed recognition requirements to various fact patterns before the proposed amendments are finalised.

We generally agree with the proposed requirements relating to the measurement of expenditures required to settle an obligation, the determination of the discount rate and transition requirements.

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Our detailed responses to the questions in the ED, along with the reasons for our concerns, are set out in the attached Appendix.

We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact me at +44 (0)7875 311782 or by email at abuchanan@bdoifra.com.

Yours faithfully

Andrew Buchanan

Andrew Buchanan

Global Head of IFRS and Corporate Reporting

Appendix

Question 1 – Present obligation recognition criteria

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?

We generally agree with the outcomes produced by applying the revised recognition criteria. For example, we believe that recognising certain levies gradually over time (e.g. a levy on revenue beyond a specified threshold) rather than at a point in time produces more useful information for users of financial statements and addresses many of the longstanding criticisms of IFRIC 21.

However, we are concerned that the recognition criteria are highly complex. IAS 37.14-14U are 22 total paragraphs which must be considered to determine whether a provision should be recognised, including three criteria (IAS 37.14A(a)-(c)) embedded within the primary recognition criteria (IAS 37.14(a)). The flowcharts included in the proposed amendments to *Guidance on Implementing IAS 37* summarise these requirements, but three flowcharts are required to do so.

We appreciate that developing recognition criteria for a wide range of economic phenomena from onerous contracts to levies is conceptually challenging, however, we are concerned that an appropriate balance between complexity and ease of application has not been achieved.

As an example, IAS 37.14P appears to set out both a recognition condition (that multiple actions that contribute to the past-event condition in aggregate) and a measurement requirement (that the liability is measured based on the portion of the total expected obligation).

Additionally, we believe that IAS 37.14P and 14Q set out inconsistent requirements. 14P applies to instances where, for example, a levy may be charged based on an entity's revenue when it exceeds a specified threshold. 14Q applies to instances where, for example, an entity must take two actions to be charged a levy (e.g. operate in one period and still be in operation in another period, such as the first day of the following period). 14Q specifies that the past-event condition is met when the entity has taken the first action and has no practical ability to avoid taking the section action. 14P does not contain a similar 'no practical ability' criterion, and instead, 14P(a) requires that an entity's activities are 'probable' to exceed the threshold. We do not understand why there is a conceptual difference in these situations, which justifies differences in the recognition criteria.

We believe the IASB should consider whether the underlying principles may be expressed in a simpler and more consistent manner, which clearly differentiate between recognition criteria and measurement considerations. This may involve restructuring the proposals both in terms of how they are expressed and how they are organised in the revised version of IAS 37.

Apart from the drafting of IAS 37, we are also concerned that the complexity of these proposals may result in inconsistent application, particularly in the case of levies. While the outcomes of applying IFRIC 21 have been long criticised, those outcomes are generally well understood as the principles of IFRIC 21 are easily expressed. We are concerned that the complexity of these proposals may result in similar facts and circumstances being accounted for differently due to their complexity.

If the IASB decides to proceed with the proposals substantially unchanged, we recommend that thorough field testing of the proposals be performed before the amendments are finalised to ensure that preparers in various jurisdictions are capable of applying the requirements consistently. Modifying the recognition criteria to align with the Conceptual Framework is a significant change to IAS 37, and we are concerned that the complexity of the requirements, as drafted, may be challenging for entities to apply. Without substantial field testing in advance and appropriate adjustments being made to the proposed amendments if necessary, we believe that the proposals may increase, rather than reduce diversity in practice.

> 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?

When the IASB proposed amendments to IAS 37 in 2019 in ED 2018/2 *Onerous Contracts – Cost of Fulfilling a Contract,* we disagreed with the proposals in our comment letter, however, given that those amendments were finalised, we agree with amending IAS 37 to make the measurement requirements consistent for different types of provisions. We see no conceptual basis for an onerous contract to be measured differently from other provisions.

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?

We generally agree with the proposed requirements, however, we believe the IASB should clarify how these revised requirements would interact with measurement requirements of other IFRS Accounting Standards, such as IFRS 3. There is longstanding diversity in practice as to how an entity that acquires a business measures an acquired provision on 'day 1' of the business combination and subsequent to the business combination.

IFRS 3 requires that the provision acquired as part of the acquired business be measured at fair value, and the measurement requirements for fair value would not exclude non-performance risk from being included in the discount rate. Applying the proposed requirements, the entity would then use a discount rate that does <u>not</u> reflect non-performance risk subsequent to the initial recognition of the provision, which results in a 'day 2' measurement difference. It is unclear under existing requirements how this difference should be accounted for, and the issue will become more prevalent if the proposals are finalised as drafted because the ED would make it clear that there is a measurement difference between 'day 1' and 'day 2'.

We recommend that the IASB consider clarifying how an entity should account for this matter, or else diversity in practice will increase in terms of the quantitative effect.

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?

We agree with the proposed transitional requirements.

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?

We agree with the proposed amendments to IFRS 19.

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?

See our comments in response to Question 1, which address our concerns many of our concerns with the proposed amendments to Guidance on Implementing IAS 37.

We have specific concerns with how some examples articulate the conclusions for the recognition criteria. For example, Example 7 concludes that the transfer condition is not because 'retraining staff will involve exchanging economic resources, not transferring an economic resource'. We do not understand this conclusion because it could be seen as implying that outsourcing an entity's obligation would result in the recognition criteria not being met. For example, in Example 2A, it is concluded that the transfer condition is met, however, practically speaking, almost all entities with obligations to remediate contaminated land will do so by obtaining services from third parties.

Question 7 – Other comments

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

We have no other comments.