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Provisions—Targeted improvements

Project update

Objective

- 1 The purpose of this session is to provide the EFRAG FRB with a short updated on the IASB's project *Provisions—Targeted improvements* and the activities planned by the EFRAG Secretariat.

Scope of the IASB project, the IASB's tentative decisions and initial input collected by the EFRAG Secretariat

- 2 The IASB has announced that it plans to issue an exposure draft in H2 2024 on three targeted amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* ('the Amendments'). The Amendments aim to:
 - (a) Clarify requirements on when an entity has a present obligation as a result of a past event.
 - (b) Specify, in relation to measurement of a provision:
 - (i) the costs an entity includes in estimating the future expenditure required to settle the entity's present obligation; and
 - (ii) the rate an entity uses to discount that future expenditure to its present value.

Requirements on when an entity has a present obligation

- 3 On the clarification on when an entity has a present obligation as a result of a past event, the IASB has not made any tentative decisions. However, the IASB staff has prepared an illustration on how the changes could look like and has received some feedback on this illustration.
- 4 The Amendments will be based on the revised Conceptual Framework.
- 5 When amending the definition of a liability and the supporting guidance in the Conceptual Framework, specific attention was paid to when an entity would have a liability in relation to provisions, for example under the circumstances covered by IFRIC 21 *Levies*. The revised Conceptual Framework (and accordingly the likely proposed Amendments) states (will state) that obligations need not be legally enforceable, but also arise when the entity has no practical ability to avoid transferring an economic resource. This means that if an entity, for example, has to pay a levy (and the levy is a non-reciprocal transaction) as soon as it generates revenue in 20X1 and the amount of the levy is based on the revenue generated

in 20X0, the entity should recognise a provision for the levy in 20X0, if the entity has no practical ability to avoid generating revenue in 20X1.

- 6 When commenting on the exposure draft for the revised Conceptual Framework, EFRAG agreed that obligations need not be legally enforceable, but also arise when the entity has no practical ability to avoid transferring an economic resource.
- 7 EFRAG was, however, concerned that the guidance in the exposure draft for the revised Conceptual Framework was not sufficiently clear. For example, when a levy would be based on various parameters.
- 8 The IASB's staff illustration of the possible changes has been discussed at an EFRAG FR TEG/CFSS meeting. Generally, tentative support was expressed for the direction of travel. Differing views were, however, expressed on the benefits of recognising a liability for a levy before the entity would have a legal obligation to pay the levy.
- 9 The discussion at the EFRAG FR TEG/CFSS meeting showed that the illustrated possible changes were interpreted differently. Comments were made that additional guidance should be developed and the Amendments proposed by the IASB should be thoroughly field tested.

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

- 10 The IASB has tentatively decided that the expenditure required to settle the entity's present obligation should be the costs that relate directly to settling that obligation, which consist of both:
 - (a) the incremental costs of settling the obligation; and
 - (b) an allocation of other costs that relate directly to settling obligations of that type.
- 11 EFRAG has not discussed the IASB's tentative decisions. However, a similar requirement was recently included in IAS 37 for the assessment of whether a contract is onerous (when the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it). When responding to the exposure draft on these changes to IAS 37, EFRAG supported including an allocation of other costs that relate directly to fulfilling contracts when determining whether a contract is onerous.

The discount rate

- 12 The IASB has tentatively decided that an entity should discount the estimated future expenditure at a rate that reflects the time value of money—represented by a risk-free rate—with no adjustment for non-performance risk.
- 13 The EFRAG FRB, EFRAG FR TEG and EFRAG CFSS have previously had the opportunity to provide views on not reflecting non-performance risk when discounting provisions. The initial views expressed were supportive of the IASB's tentative decision. However, it has also, for example, been noted that it is difficult to consider the risks to be reflected in the discount rate, without also considering the risks to be reflected in the estimated cash outflows.

Issues not covered

- 14 The IASB has tentatively decided not to deal with other issues than those presented in paragraph 2. During the IASB's discussions, IASB members have presented various arguments for not extending the scope. One of the reasons provided has been that there

are other projects, users of financial statements generally consider more important for the IASB to deal with.

- 15 At previous EFRAG FR TEG/CFSS/FRB meetings, some members have expressed the views that the project should also consider additional issues. Most frequently, the following additional issues have been mentioned:
- (a) How to take ‘detection risk’ into account when accounting for provisions.
 - (b) How to deal with inflation when discounting provisions.

Activities planned by the EFRAG Secretariat

- 16 The EFRAG Secretariat currently plans to start the discussions of EFRAG FR TEG in April 2024, after the EFRAG FR TEG rotation. Until the publication of the IASB’s exposure draft, discussions will be based on the IASB’s tentative decisions.
- 17 The EFRAG FRB has previously categorised the project as a ‘low priority’ for the purpose of allocating EFRAG Secretariat resources to projects. This means that the EFRAG Secretariat will only collect input from the EFRAG FRB, EFRAG FR TEG, EFRAG FR TEG working groups and constituents replying to EFRAG’s Draft Comment Letter when finalising EFRAG’s comment letter to the IASB on the proposed Amendments.
- 18 Accordingly, the EFRAG Secretariat will not conduct field tests of the proposed Amendments (contrary to what was requested at an EFRAG CFSS/EFRAG FR TEG meeting (see paragraph 9 above)).

Questions for the EFRAG FRB

- 19 Does the EFRAG FRB have any comments on this update? The EFRAG FRB will have the opportunity to provide its views on the IASB’s proposed Amendments at a later stage. The EFRAG Secretariat is accordingly particularly interested in receiving notification of any concerns related to the activities it has planned (and not planned).