SAICA DIFFERENCE MAKERS™

12 March 2025

International Accounting Standards Board
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Email: commentletters@ifrs.org

Dear Sir/Madam

SAICA SUBMISSION ON ED/2024/8 – *PROVISIONS – TARGETED IMPROVEMENTS* – PROPOSED AMENDMENTS TO IAS 37

In response to your request for comments on ED/2024/8 – *Provisions – Targeted Improvements* – Proposed amendments to IAS 37, attached is the comment letter prepared by the South African Institute of Chartered Accountants (SAICA). This comment letter results from deliberations of SAICA's Accounting Practices Committee (APC), which comprises members from reporting organisations, preparers, regulators, auditors, IFRS specialists, investment analysts and academics.

We thank you for the opportunity to provide comments on this Exposure Draft.

Please do not hesitate to contact us should you wish to discuss any of our comments.

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Chairperson: APC

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SPECIFIC COMMENTS

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?*

We agree with the proposal to update the definition of a liability in this exposure draft to be aligned to the definition in the Conceptual Framework.

We broadly agree with the other proposals in this question, except in certain aspects as outlined below. We have identified some concerns that may introduce unintended consequences and we have raised suggestions to address the concerns.

Detection risk in ED paragraph 14A(c)

Detection risk is discussed in IFRIC 23 *Uncertain tax positions*. It is unclear whether the omission of detection risk in the Exposure Draft is deliberate, and that detection risk should be considered in either the past event condition and/or the measurement of the provision; or whether detection risk should be ignored, which is the view in IFRIC 23. We therefore ask the Board to specifically address detection risk in IAS 37. Our suggestion is that the detection risk considerations be aligned to the view on detection risk in IFRIC 23 paragraph 8.

Constructive obligation in ED paragraph 14F(a)(ii)

Unlike the assessment of a legal obligation, *the economic consequences of an entity not discharging its responsibility* (paragraph 14F(a)(ii) of the Exposure Draft) are not considered when assessing a constructive obligation. We believe this consideration would be more relevant in the context of constructive obligations. Without a legal mechanism to impose a responsibility, the expectation of other parties creates the responsibility for a constructive obligation. Therefore, if the consequences of not fulfilling the obligation are not significant, the entity might conclude that it does not have an obligation to fulfil its responsibility. We suggest that the Board consider incorporating the same economic consequences assessment for constructive obligations in ED paragraph 14F(b).

No practical ability to avoid discharging its responsibility in paragraph 14B of the Exposure Draft

The current proposed amendments do not provide clear enough guidance or illustrative examples on how to assess when an entity has "*no practical ability to avoid discharging its responsibility*" (Exposure Draft paragraph 14B). In the proposed examples, this requirement has been assumed to be met. This can cause practical application challenges due to uncertainty around how to apply the standard's requirements. Therefore, we request including additional guidance and an example to help entities to make this assessment.

Pattern of expense recognition in paragraph 14O linked to 14R of the Exposure Draft

Paragraph 14O refers to economic benefits obtained, or actions taken over time. The phrase "*resulting present obligation accumulates over that time*" creates confusion regarding the timeframe for recognising a provision. We note that paragraph 14R explains that a decision to prepare financial statements on a going concern basis implies that an entity has no practical ability to avoid taking an action. These two paragraphs in combination creates the possibility of an open-ended timeframe for the recognition of the related provision. Clarity is required as to the timeframe for the recognition of the provision - is this only in relation to the current period or does it include actions to be taken in the future as well?

For example, an entity creates a constructive obligation to provide a bursary to a student for a five-year period. Does this action take place over time, because the bursary is for a 5-year period, or is the past-event condition met on day 1 because the action of committing to the bursary has been met? The current wording implies that entities should book a provision for the entire five-year period upfront.

Furthermore, the example in para 14P might result in a perpetual obligation because paragraph 14R indicates that preparing financial statements on a going concern basis implies that an entity has no practical ability to avoid taking an action. This suggests that the obligation to pay the levy could be recognised continuously as long as the entity expects to generate revenue above the threshold, which creates the possibility of an open-ended timeframe for recognising the provision.

We would propose the following amendment to the wording in paragraph 14O to provide clarity with respect to the timeframe for recognition and measurement:

“If the economic benefits are obtained, or the second action is taken, over time, the past-event condition is met, and the resulting present obligation accumulates, over that time. If there is only one action, then the present obligation accumulates when that action occurs. (ie, point in time or over that time)”

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?*

We broadly agree with this proposal; however, we struggle to apply the proposed Exposure Draft requirements to the following practical examples:

Costs that relate directly to an obligation in paragraph 40A of the Exposure Draft

The Exposure Draft lacks clarity regarding the definition of "*costs that relate directly to an obligation*" in paragraph 40A of the Exposure Draft, and whether this includes anticipated future costs yet to be incurred. For example, it is unclear if an entity should provide for anticipated costs such as legal fees directly related to settling an obligation, or future sales taxes/VAT expected upon the purchase of goods or services even where the obligation for the future sales tax/VAT has not yet arisen and the legal fees have not yet been received.

An example of costs that could be interpreted as directly related to settling an obligation (as per Exposure Draft paragraph 40(A) is capital expenditure required for activities such as mine restoration costs. Mine restoration costs include salaries for those performing the rehabilitation, as well as costs to purchase capital assets necessary for the rehabilitation. When considering Exposure Draft paragraph 14A, a provision is recognised for the rehabilitation as the mining is performed, but only for the employee costs. The capital expenditure is considered an exchange transaction, and therefore, the requirements of paragraph 14A(b) of the Exposure Draft are not met. However, when considering the measurement of the provision, we seek clarity on whether the capital cost should be considered a cost that is incremental to the obligation, and/or an allocation of other costs that directly relate to settling these types of obligations; and therefore, included in the measurement of the provision. This is on the basis that the capital expenditure would not be required if not for the obligation to rehabilitate. This issue is significant for extractive industries, and we request

clarification on which costs should be included in the measurement of a provision, specifically where the requirements of paragraph 14A(b) of the Exposure Draft are not met for the costs.

Furthermore, there is no guidance in the basis for conclusions around the words “obligations of that type”. We suggest the wording be changed to:

“...(b) an allocation of other costs that relate directly to settling that obligation”

This aligns to paragraph 40A(a) and paragraph 40A(b) to speak to “that obligation” and would aid in removing the confusion about what is meant by “settling obligations of that type”.

Another example is a spurious legal claim. The entity has an obligation to defend itself in order to get the legal claim dismissed. If the entity does not defend itself, there may be a judgement and a fine or damages payable as a result, thus costs will need to be incurred until the claim is resolved. However, there may be no provision for the claim because it has no merit. When reading Exposure Draft paragraph 40A, we would conclude that no provision should be recognised for the legal costs, because there is no obligation. Therefore, it is unclear if the principal in paragraph 40A of the Exposure Draft applies to only recognised obligations, or obligations that the entity has to defend itself.

We require clarity as to whether the IASB stating that a spurious legal claim is not an obligation until any judgement is determined. In other words, in the event of a spurious legal claim, does the past event criteria for recognition become the final judgement?

Real or nominal costs

The proposed amendments are unclear regarding whether the costs included in the measurement of the provision should be inflation-adjusted (i.e., real costs) or nominal costs. We recommend that the Board explicitly state whether entities should consider inflation in the measurement of a provision to reduce diversity in practice.

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?*

Proposed discount rate requirements:

We agree with the proposed discount rate requirements.

Paragraph 47A of the Exposure Draft explicitly states that non-performance risk is excluded from the discount rate. However, the amendments do not address whether non-performance risk should be considered in the cash flows when measuring a provision. This ambiguity may lead entities to include non-performance risk in the cash flows to achieve a similar outcome as incorporating it in the discount rate. We note that IAS 37 BC 36 seems to state that non-performance risk should not be considered for the measurement of the provision at all. Therefore, if the Board's intention is to exclude non-performance risk entirely from the measurement of a provision, we recommend that the standard explicitly clarify this point.

An example scenario where this might be applicable is when entities are jointly and severally liable for settling an obligation. The question arises whether all jointly and severally liable entities need to recognise a provision and if the measurement should be identical for each entity. Alternatively, should each entity consider the likelihood that another entity might make the payment, thereby relieving the entity in question from performing? In such cases, does the likelihood of non-performance by one of the entities impact the measurement of the provision? Similarly, in another scenario, considering non-performance risk in the measurement of a rehabilitation provision could decrease the measurement, which may not accurately reflect the entity's commitment.

Proposed disclosure requirements:

We broadly agree with the proposed discount rate disclosures; however, we request the Board to provide clarity on the matter discussed below.

The proposed disclosure requirements appear to be written from the perspective of a standalone entity, not a consolidated group. In group scenarios where multiple subsidiaries have recognised provisions, it is unclear whether the discount rate should be disclosed for each subsidiary or only for the ultimate parent. If the discount rate used for each subsidiary must be disclosed, the requirements could become quite onerous. We recommend that the Board clarify the expected disclosure requirements for a consolidated group, potentially bringing in a materiality overlay, to avoid confusion and ensure consistency. In clarifying this requirement, the Board could consider state that in consolidated group circumstances, disclosure could be provided in the form of weighted averages, or relatively narrow ranges which is consistent with the requirements in paragraph 120 of IFRS 17 for disclosure related to a number of groups of insurance of contracts.

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?*

Transition requirements

We agree with the proposals except for the aspects listed below:

Paragraphs 94B and 94C of the Exposure Draft suggest that provisions should be retrospectively adjusted. However, paragraph 94D(a) of the Exposure Draft contains an exception to the cost adjustment for provisions not yet settled at the date of initial application. We recommend that paragraph 94B of the Exposure Draft be updated to explain that the transition requirements only apply to those provisions that still exist at the date of initial application.

Paragraph 94E(b) of the Exposure Draft requires an entity to apportion an adjustment to a provision arising from a change in the discount rate between the related asset and retained earnings. This new and complex requirement could cause confusion among preparers, especially when needing to consider historic impairments of mining assets to which IFRIC 1 may have applied. We therefore suggest that the Board

consider providing an illustrative example to clarify the application of these requirements and ensure a consistent approach.

Paragraphs 94D and 94E of the Exposure Draft indicate that the transition requirements apply to entities that change their accounting policy for costs and discount rates. We believe that entities would not voluntarily change their accounting policy but would be required to update the measurement of their provisions in accordance with the amendments to the standard. Therefore, we suggest updating the wording to clarify that entities are required to update the measurement of their provisions. An example of suggested wording is included below:

“If an entity updates the costs included (Exposure Draft paragraph 94D) or the discount rate used (Exposure Draft paragraph 94E) in the measurement of a provision in order to comply with the amendments to the standard …”

Effective date

We suggest that the Board consider setting the effective date of the amendments to be at least two years after the effective date of IFRS 18 *Presentation and Disclosure in Financial Statements*. IFRS 18 will have a pervasive and material impact on the financial statements of all entities. Therefore, we recommend providing preparers with sufficient time to implement IFRS 18 before adjusting the accounting for provisions as required by the amendments to this 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?*

The majority of the participants agree with this proposal.

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?*

We find the proposed decision tree and examples helpful in illustrating the application of the requirements. However, we believe there is potential to enhance some of the examples to provide additional clarity and eliminate potential confusion.

Overall comments:

Objective and Specific Requirements of Illustrative Examples

Each example is intended to illustrate the application of a specific requirement in the standard. Therefore, it would be useful to indicate the objective of each example and the specific requirement of the standard to which it relates. This would make it easier for users to determine the appropriate scenario for applying each example.

Application of Recognition Criteria to Out-of-Scope Transactions

We observed that some of the proposed illustrative examples apply all the recognition criteria to transactions that are out of scope of the standard or have failed either the first or second recognition criteria. Specifically:

- Example 6 illustrates the decision tree for a contract that would not fall within the scope of IAS 37, as the purchase of smoke filters would be an exchange transaction.
- In Example 11A, even when the obligating event criterion is not met, and in Example 11B, when the transfer condition is not met, the illustration continues to assess the other recognition criteria.

Some participants do not believe it is useful to illustrate the application of the entire decision tree to transactions outside the scope of the standard or where one of the recognition criteria has failed. Accordingly, the recommendation is that if a transaction is not within the scope of IAS 37, or it fails the first or second criterion according to the flow chart, the remaining recognition criteria should not be considered.

Application of the "*no practical ability to avoid*" criterion

We refer you to our response under Question 1 where we suggested an example illustrating how an entity would assess whether it has no practical ability to avoid settling an obligation.

Example 2A — Contaminated land: legislation virtually certain to be enacted

Paragraph 14G of the Exposure Draft, which explains the concept of "*virtually certain to be enacted*", indicates that in many cases it is virtually impossible to be virtually certain of the enactment of a law until it is enacted. However, in Illustrative example 2A, the example concludes it was virtually certain that the draft law will be enacted at year end. We believe that this example could be perceived as contradictory to paragraph 14G of the Exposure Draft. In addition, we are of the opinion that the wording "*will be enacted shortly after the year-end"* used in Illustrative example 2A gives rise to an IAS 10 *Events after the reporting* period consideration. If the law was enacted shortly after year-end, then it would have been virtually certain to be enacted at year-end. We suggest that in order to demonstrate the more practical and likely scenario as envisaged in paragraph 14G, the Board consider updating the example to explain that in applying paragraph 14A(a) of the Exposure Draft, there is no obligation because it is not virtually certain that the law will be enacted at year end.

Example 5B — Closure of a division: Communication/implementation before end of the reporting period

This example has overlapping considerations with IFRS 15 *Revenue from Contracts with Customers* as it considers a scenario involving contractual termination penalties payable to a customer. We believe that the customer contract termination benefits are variable consideration in the scope of IFRS 15 and should therefore be removed from this example. Alternatively, if the information related to the contractual termination penalties is left in the example, we suggest that the example is updated to conclude that the specific customer contract penalty amounts are accounted for in terms of IFRS 15.

Example 7 — Staff retraining as a result of changes in the income tax system

In this example, it is concluded that the obligation criterion is not met as the responsibility for retraining staff is not owed to another party. However, given that the mechanism which imposes the responsibility on the entity to retrain staff is a financial service regulation which would generally be considered to be of public interest. , we contend that there is a potential obligation as the entity would have an obligation to the larger society to ensure its staff are appropriately trained. We therefore suggest that the Board address this in the example.

Example 11A — Refurbishment costs: no legislative requirement and Example 11B – Refurbishment costs: legislative requirement

The decision tree indicates that once an entity fails one of the criteria to recognise a provision, the transaction or event is out of scope of IAS 37. However, in Example 11A, even when the

obligating event criterion is not met, and in Example 11B, when the transfer condition is not met, the illustration continues to assess the other criteria.

Example 13C — A property tax

It is unclear how the proposed requirements interact with *IAS 34 Interim Financial Statements.* We therefore suggest the Board include further guidance to clarify whether and how an entity should recognise a provision for property tax and the associated expense in its interim financial statements. We suggest this as IFRIC 21 will be removed as a consequence of this Exposure Draft, and there has been no consequential amendments to IAS 34 *Interim Financial Statements.* Therefore, including guidance on transitioning traditional IFRIC 21 liabilities to principles in the Exposure Draft in IAS 34 *Interim Financial Statements* would be necessary.

Example 14 — Negative low-emission vehicle credits

The application of the transfer condition suggests that an entity transfers an economic resource to itself by using positive credits to offset negative credits, rather than transferring them to a third party. This raises the question of whether the entity is recognising a provision for an opportunity cost, i.e., the cost of not using the positive credits in another way. The phrase "*if the entity were not required to use the positive credits in this way, it could have sold them to other entities*" suggests this.

Additionally, it is unclear from Example 14 how this provision would reverse when the credits are surrendered. Since the obligation is not settled in cash, it suggests that it would be recognised as income or revenue, but the accounting treatment is not clear. The implication is that entities can recognise profits on "selling" items to themselves which is not congruent with IFRS 15 or the Conceptual Framework. We suggest that the Board clarify the appropriate measurement of the provision as part of Example 14 and explain the credit entry once the positive credits are generated, as well as the rationale behind it.

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

Disclosure of comparatives

IAS 37 is the only IFRS Accounting Standard that does not require the disclosure of comparatives. We suggest that the Board reconsider the comparative requirement as part of issuing these amendments. Specifically, some members recommend either including comparatives as a requirement of the standard or removing the sentence in paragraph 84 that states comparatives are not required.

Unit of account and application of bottom-up vs consolidation approach

We read the Exposure Draft such that the unit of account is the lowest level of the potential provision. This seems to align to the discussion in IAS 37 paragraph 23 and 24. We recommend specifically addressing the unit of account being the lowest individual provision in the scope section of the standard. Furthermore, once a provision is recognised at this lowest level and it forms part of a consolidated set of financial statements, it is unclear if the definition of a provision needs to be reconsidered again from the perspective of the consolidated financial statements.