

AUSTRIAN FINANCIAL REPORTING ADVISORY COMMITTEE  
c/o KAMMER DER STEUERBERATER:INNEN UND WIRTSCHAFTSPRÜFER:INNEN  
AM BELVEDERE 10 | TOP 4  
A-1100 VIENNA  
AUSTRIA

TEL +43 (1) 81173 228  
FAX +43 (1) 81173 100  
E-MAIL [office@frac.at](mailto:office@frac.at)  
WEB <http://www.frac.at>

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IFRS Foundation  
7 Westferry Circus, Canary Wharf  
London E14 4HD  
United Kingdom  
[commentletters@ifrs.org](mailto:commentletters@ifrs.org)

Comments on Exposure Draft "Provisions – Targeted Improvements Proposed  
Amendments to IAS 37"

Dear Madam, dear Sir,

On behalf of the Austrian Financial Reporting Advisory Committee (AFRAC), the privately organised standard-setting body for financial and other corporate reporting in Austria, we appreciate the opportunity to comment on the Exposure Draft "Provisions – Targeted Improvements Proposed Amendments to IAS 37".

Principal authors of this comment letter were Stefan Dankovsky, Daniela Frei, Christian Groß, Christian Höllerschmid, Erich Kandler, Helmut Kerschbaumer (chair), Christoph Krischanitz, and Aslan Milla. In order to ensure a balanced Austrian view on the consultation, these authors have different professional backgrounds.

Best regards,  
Romuald Bertl  
Chairman

**Comments on Exposure Draft "Provisions – Targeted Improvements Proposed Amendments to IAS 37"**

**General comments**

We appreciate and support the IASB's efforts to continually improve the requirements in its Standards and to include IFRIC Interpretations into existing Standards. For the proposed project, this especially relates to the clarification of the discount rate and the cost definition used in measuring provisions. However, we have some concerns regarding the proposed amendments to the recognition requirements, especially because these requirements may lead to an earlier recognition of some provisions. We are concerned that such significant change could have consequences which might go beyond the intended results. We observed that especially the incorporation of issues dealt with in IFRIC 21 may have unwanted side effects and, therefore, might be difficult to be implemented.

In addition, the proposed amendments appear unnecessarily complex, because the present obligation recognition criterion is subdivided into three conditions, whereby all requirements are written into one paragraph number (14) with 21 (!) sub numbers (A – U). In practice, we did not observe significant issues in connection with the first recognition criterion (except those issues which are dealt with in IFRIC 6 and IFRIC 21) and, therefore, we do not see the need for such significant change. In other words: we think that the costs resulting from the increased complexity could exceed the potential benefits associated with these amendments.

Please see below for more details.

**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?*

## **AFRAC's response to Question 1:**

### **Recognition – complexity**

Replacing the current definition of an obligating event with requirements to meet three separate conditions appears to unnecessarily increase the complexity of the standard without significant benefits. For example, introducing the transfer condition as a separate requirement in Para 14 (a) does not, in our view, affect the decision whether a provision must be recognized, because the transfer criterion included in (b) would prohibit recognition if the entity would not be required to transfer an economic resource. Although subsequent rules on contingent liabilities can be deduced more clearly by including the transfer condition also in Para 14 (a), this benefit may not outweigh the cost from making the recognition criterion redundant and overly complex. We suggest reconsidering these comprehensive changes to the recognition section of the standard and amending the existing wording of IAS 37 only as much as necessary to bring it in line with the Conceptual Framework.

### **Recognition – Obligation condition**

Para 14B introduces a new wording ("mechanism") aiming to improve the requirements for laws and regulations with novel enforcement mechanisms or settlement options. BC15 explains that this is necessary because some new laws and regulations have features that differ from those of conventional laws. The examples given in BC15 are obligations arising under some climate-related regulations which are not conventionally enforceable or the option to settle obligations by changing future operations instead of by paying penalties.

We understand the intention of the suggested amendment. However, we think that the wording in Para 14B and especially the examples included in BC15, confuse the obligation condition with the nature of the transfer required to settle the obligation (transfer condition). Having an obligation means that the entity has no practical ability to avoid discharging the responsibility. As stated in Para 14, such obligation could be either legal (by contract or law) or constructive. Therefore, we do not see any need for other "mechanisms". The examples provided in BC15 and BC16 are all based on regulations, i.e. legal requirements.

Regarding the example in BC15, we do not support a wording that appears to require recognition of a provision for situations in which changing the future operations would be sufficient to settle such an obligation. We think this wording does not reflect the guidance in the ED and is therefore misleading. Moreover, a potential paradigm shift towards a more forward-looking recognition of provisions might not be intended by the IASB.

Example 14 (negative low-emission vehicle credits) and Example 15 (climate-related commitments) included in the guidance on implementing IAS 37 appear reasonable based on the facts stated in the guidance. However, if in Example 14 the facts were modified in a way that the elimination of the credits was not required in 20X0, but in subsequent years (e.g. in 20X4), the question would arise in which period the provision should be recognized. Possible solutions could be to require the recognition (a) in the period when the negative credits are generated (i.e. from 20X0 on), (b) in the period when it becomes more likely than not that the economic consequences for the entity of restricted market access would be significantly more adverse than the costs of obtaining and surrendering enough

positive credits or (c) in 20X3, i.e. when management expects such economic consequences to occur. We suggest providing further guidance on this question.

### **Recognition – past-event condition**

We generally support the effort to include in the standard guidance on issues previously dealt with in IFRIC 6 and IFRIC 21. However, we are concerned that replacing Para 18 and 19 with Para 14M to 14R may have effects that go beyond the issues dealt with in IFRIC 21.

Para 19 did not allow the recognition of a provision if the entity could avoid the future expenditure by its future actions, for example by changing its method of operation. In order to deal with IFRIC 21 issues, para 14Q now opens this strict rule to allow the recognition of a provision in situations, where an obligation to transfer an economic resource depends on a future action and the entity has no practical ability to avoid taking this future action.

While we acknowledge that this amendment is in line with the Conceptual Framework, we think that its interpretation should be narrowly tailored. Based on this assumption, we are concerned that the proposed wording in para 14Q may not be sufficient. For example, applying the wording "... if it takes two (or more) separate actions ...", may be unclear in cases where "one action" is mainly used to measure the liability. An example for that may be a levy attributable to the current year, where the extend of the amount is a percentage of prior period net sales. Such cases remain open to interpretation and may lead to significant diversity in practice as it is not straightforward to apply Para 14Q by analogy.

We are therefore concerned that these proposed amendments could require the recognition of a provision in cases that go beyond IFRC 21 issues. Basically, recognition of a provision may become obligatory in situations where an entity is required by a legal or constructive obligation to incur expenses in order to ensure future operations. This could constitute a significant change as compared to current practice/requirements and might have a material effect on the results and financial position of companies affected by this change.

Examples of such situations are:

- Based on the underlying contract with the government, an operator of public infrastructure (e.g. highways, gas or electricity grids) needs to keep the infrastructure in a certain condition, i.e. which requires certain maintenance work not eligible for capitalization and which is caused by the condition of the infrastructure assets as at the reporting date. Currently, if the maintenance work is not yet executed, a provision is recognized for expenses expected to be required within the earliest possible termination period, because any expenditure beyond the termination period would only be incurred if the entity continued to operate the infrastructure beyond the current period and would therefore be conditional on the entity's future actions. According to the proposed wording, the period to be considered in measuring such a provision could be significantly longer (and is likely subject to discretion).

- In addition, we believe that regulatory liabilities (e.g. of grid operators) from fees charged to customers higher than the costs actually incurred would need to be recognized under the amended IAS 37 rules.<sup>1</sup>

We therefore encourage the IASB to consider whether such a far-reaching change concerning the recognition of provisions is intended and, if so, to conduct further field testing to gain a clearer picture of the consequences triggered by the proposed changes. Alternatively, the standard setting could take a more conservative approach regarding the recognition criterion, i.e. changing the wording only if necessary in order to be consistent with the Conceptual Framework.

As an alternative approach, the Board may consider not to implement IFRIC 21 issues into IAS 37, but to deal with these issues separately, e.g. in a separate standard or together with the project on rate regulated activities. This could avoid the significant amendment to IAS 37.

**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?*

**AFRAC’s response to Question 2:**

We agree with the proposal to include all costs that are directly related to the obligation when measuring the expenditure required to settle the obligation.

As mentioned in BC16, provisions may not only relate to contracts to deliver goods or provide services but may also comprise obligations which are settled by the payment of cash (e.g. in a lawsuit relating to patent infringements). While the measurement of costs directly related to the delivery of goods or the provision of services will be consistent with other IFRS Standards such as IAS 2, IAS 16 or IFRS 15, questions arise on how to apply the proposed amendment to such other settlement types. Examples are costs of a legal department to handle a lawsuit or costs for actuarial services necessary to determine termination benefit amounts to be settled. Such costs are directly related to the obligation and are similar in nature to, for example, costs for plant management at manufacturing plants or costs for specialists when providing specific services. On the other hand, if such costs were to be included in measuring the provision, this could lead to inconsistencies with other IFRS Standards. For example, IAS 19 does not require or allow the inclusion of costs that relate directly to the obligation (e.g. costs for using actuarial services to determine benefits) when measuring the defined benefit obligation.

Based on these considerations, we suggest including further guidance especially for obligations, which do not provide for the delivery of goods or provision of services. Such guidance should also be accompanied by illustrative examples embedded in the standard text or examples in the implementation guidance.

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<sup>1</sup> This issue will be part of the IASB’s rate-regulated activities project.

**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?*

**AFRAC’s response to Question 3:**

We agree with the proposed discount rate requirements.

With respect to the disclosure requirements, we understand the need to disclose the interest rates used in measuring the provision. However, we suggest that the IASB reconsider whether the requirement to disclose the approach used should be required. The main reason for our concern is that the relevance of such information may be limited as (a) comparability appears sufficiently supported by the disclosure of the rate(s) and (b) there is a certain danger that boilerplate language will be used for these disclosures. In addition – considering the IASB’s disclosure initiative – any additional disclosures should only be required if the benefits exceed the costs.

As an alternative, we suggest considering a requirement to disclose the approach used to determine the interest rate only in those cases, where the interest rate applied reflects risks concerning the amount or timing of the expenditure required to settle the obligation.

**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?*

#### **AFRAC's response to Question 4:**

We agree with the proposal to allow a modified retrospective application. With respect to changes in the accounting policy for the costs included in the measurement of a provision, we understand the reasons for recognising the cumulative adjustment effect at the date of initial application as outlined in BC20 to BC21 of the Basis for Conclusions of the Amendments to IAS 37 in 2020. However, we also observe a need for providing properly adjusted comparative information for stakeholders, for example, in cases where specified GAAP measures are used for determining management and employee bonuses. Compared to the amendments in 2020, when the change in IAS 37 may have triggered the recognition of a previously unrecognized provision, the adjustment of costs included in a measure of a provision, which has already been recognized in prior years, will be less complex. Therefore, considering cost-benefit implications, we suggest including an option to apply a full retrospective application also for changes in the accounting policy for the costs included in the measurement of a provision. Such an option should be consistently applied in all comparable situations. We have not identified significant factors the IASB should consider in assessing the time needed to prepare for the amendments proposed.

#### **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?*

#### **AFRAC's response to Question 5:**

We 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?*

**AFRAC’s response to Question 6:**

As outlined in our answers to question 1 and 2 we suggest adding additional examples or modifying existing examples. Please see above.

**Question 7—Other comments**

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

**AFRAC’s response to Question 7**

We have no further comments.