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International Accounting Standards Board
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Canary Wharf
London E14 4HD
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Dear Board Members,

RESPONSE TO EXPOSURE DRAFT *PROVISIONS – TARGETED IMPROVEMENTS (PROPOSED AMENDMENTS TO IAS 37)* (“ED”)

ISCA sought views from its members through a 2-month public consultation and from the ISCA Financial Reporting Committee which comprises experienced technical professionals from audit firms, preparers of financial statements and other stakeholders.

We appreciate and support the IASB’s commitment and efforts to providing clarity to the requirements in IAS 37, which includes provision of additional and updated illustrative examples to aid in understanding of the concepts. These certainly would help improve financial reporting.

We are generally supportive of the proposals in the ED and have highlighted areas where further clarifications or enhancements could be made.

Our detailed comments to specific questions in the ED are set out below.

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?

1. Proposed paragraph 14B(a) of IAS 37

One of the conditions supporting the proposed present obligation recognition criterion is that the entity has an obligation (paragraph 14A(a)) if a mechanism is in place that imposes a responsibility on the entity if it obtains specific economic benefits or <u>takes a specific action</u> (paragraph 14B(a)).

It would be helpful if the IASB clarifies if the continuation of an existing action could be considered as “taking a specific action”.

2. Proposed paragraph 14C(a) of IAS 37

Proposed paragraph 14C(a) states that the mechanism (as stated in paragraph 14B(a)) could be legal (a contract, legislation or other operation of law).

We are concerned that the above might have consequential impact on another IFRS Accounting Standard. For instance, paragraph AG12 of IAS 32 states that "liabilities or assets that are not contractual are not financial liabilities or financial assets… Similarly, constructive obligations, as defined in IAS 37, do not arise from contracts and are not financial liabilities." It would be beneficial if the IASB could provide guidance and/or examples to explain how to distinguish a liability under IAS 37 from that under IAS 32 and IFRS 9 which arise from an obligation mentioned in a contract.

3. Proposed paragraph 14F(a)(ii) of IAS 37

The proposed paragraph 14F(a)(ii) of IAS 37 states that the entity has no practical ability to avoid discharging a legal obligation if "the economic consequences for the entity of not discharging the responsibility are expected to be significantly worse than the costs of discharging it". However, this assessment of "economic consequences" is notably absent from the proposed paragraph 14F(b), which covers constructive obligation, where its importance arguably increases.

We suggest that the IASB consider incorporating the assessment of "economic consequences" in the proposed paragraphs 14F(b) and 14H of IAS 37. Otherwise, we suggest that the IASB provides an explanation for excluding the assessment of "economic consequences" from constructive obligations.

4. Proposed paragraph 14G of IAS 37

The proposed paragraph 14G of IAS 37 states that "If details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is <u>virtually certain to be enacted</u> as drafted. In this Standard, such an obligation is treated as a legal obligation…In many cases it will be <u>impossible to be virtually certain of the enactment of a law until it is enacted</u>."

Reading the above, it could be interpreted that the legal obligation would only arise when the law is enacted instead of when the law is virtually certain to be enacted. Only when a law is enacted, it would have legislative powers to enforce requirements on entities. In our view, this interpretation of the legal obligation arising only when the law is enacted would be in line with the requirement in paragraph 14B(a) which states that there is a mechanism (in this case, mechanism to legally enforce the requirements) in place that imposes a responsibility on the entity.

For avoidance of doubt as to the interpretation of the said paragraph, we would suggest for the IASB to clearly state that "an obligation arises only when the legislation is enacted".

5. Proposed paragraph 14P of IAS 37

The proposed paragraph 14P of IAS 37 sets out guidance on when the past-event condition is met for situations where the entity's activities exceed a specific threshold. Specifically, it states that the entity recognises a provision if it is <u>probable</u> that the entity's activity will exceed the threshold, and a reliable estimate can be made of the amount of the obligation.

We are concerned that there could be confusion about whether the above probability assessment should be regarded as part of the assessment of whether the outflow of resources is probable (paragraph 14(b)). It could be argued that 'a revenue above a specified threshold' is a measurement basis for the provision instead of being a past event. This would lead to difficulties in applying a judgement separating a measurement basis from a criterion for recognising a provision under proposed paragraph 14A.

We suggest for the IASB to provide clarity in this area.

6. Proposed paragraph 14Q of IAS 37

The proposed paragraph 14Q of IAS 37 sets out guidance on when the past-event condition is met for situations where the entity takes two (or more) actions. It further states that the past-event condition is met when the entity has taken the first action and has no practical ability to avoid taking the second (or the remaining) action(s). This appears to be a two-part test.

For threshold-based liabilities (covered in proposed paragraph 14P of IAS 37), it also appears to be a two-part test but the first test is to consider the probability of the entity exceeding the threshold instead of the entity having no practical ability to avoid exceeding the threshold; and this test appears to be part of the assessment of whether the outflow of resources is probable under paragraph 14(b) [please see earlier comments in Point 3].

For consistency, we suggest for the IASB to align the tests under paragraph 14P and 14Q of IAS 37.

We also like to suggest for the IASB to consider providing guidance in the following situations:

- There could be situations where an entity incurs an obligation if it operates in an industry and that industry exceeds a specific threshold. As it is unclear how the proposals in proposed paragraphs 14P and 14Q could apply to such situations, we suggest for the IASB to provide guidance on this.
- There could be situations where an entity has to meet a revenue target on a monthly basis over the period of one year. In which case, it is unclear whether this is considered a 'single action' performed over time or a series of 'multiple actions'. If it is the former, then proposed paragraphs 14O and 14P of IAS 37 would apply. If it is the latter, then proposed paragraphs 14Q would apply. The assessments required under the said paragraphs are different. Hence, we suggest for the IASB to consider providing guidance to aid entities in applying the appropriate requirements.

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?

1. Proposed paragraph 40A of IAS 37

The IASB has proposed to specify the costs to include in measuring a provision consist of (i) the incremental costs of settling that obligation and (ii) an allocation of other costs that relate directly to settling obligations of that type. This proposal clarifies that the costs used to measure all other provisions within the scope of IAS 37 are consistent with those costs used to measure an onerous contract provision under IAS 37.

We agree in principle the above proposal except for the following area which, in our view, requires further clarification and assessment by the IASB.

From the proposal, it is unclear whether the cost includes any associated goods or services that must be procured in the future to settle the obligation, such as anticipated future legal fees directly related to a legal case. It would be beneficial for the IASB to provide clarity in terms of examples of costs that should be considered.

We noted that the IASB has proposed to remove paragraph 18 of IAS 37 in this ED. This would be a departure from the long-held principle that "no provision is recognised for costs that need to be incurred to operate in the future" in paragraph 18 of IAS 37. We are concerned that there might be unintended consequences arising from it. Hence, we would suggest for the IASB to further assess the impact of this change.

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 agree with the proposals and would like to highlight the following areas for further clarification by the IASB.

1. Proposed paragraph 47A of IAS 37

The IASB has proposed to require provisions be discounted using a risk-free rate which <u>excludes the entity's non-performance risk</u>.

(i) Unclear if non-performance risk is to be removed in its entirety from measurement of provisions under IAS 37

Even though the IASB has proposed to exclude the entity's non-performance risk from the discount rate, we understand that some entities might still include it in the cash flows used to measure the provisions in order to achieve the same measurement outcome as if the said risk is included in the discount rate. Hence, if the IASB intends to remove non-performance risk in its entirety from the measurement of provisions under IAS 37, we suggest for this to be stated clearly and explicitly.

(ii) Exclusion of non-performance risk from measurement of provisions under IAS 37 will create differences in fair value measurement basis for liabilities under IFRS 3 and IFRS 9

Arising from our earlier comment in (i), if the IASB intends to remove non-performance risk in its entirety from the measurement of provisions under IAS 37, this will create differences in fair value measurement basis for liabilities under IFRS 3 and IFRS 9, where non-performance risk is typically included in the discount rate. This difference in discount rates will introduce arbitrary differences in the measurement of liabilities, such as provisions acquired as part of business combinations. Hence, we suggest for the IASB to provide clarity on the interaction of the requirements under IAS 37 (in respect of the measurement of provisions) and that of IFRS 3 and IFRS 9.

2. Proposed paragraph 47(a) of IAS 37

The IASB has proposed to require provisions be discounted using a <u>risk-free rate</u>; and it further explained in paragraph BC81 its rationale for not adding application guidance to IAS 37 on how an entity determines the said risk-free rate.

Notwithstanding the reasons mentioned in paragraph BC81, we are of the view that it would be good to include some guidance to aid entities in determining the risk-free rate. For this, the IASB could consider using the wordings in paragraph BC82 which states that "typically, entities determine an appropriate risk-free rate by reference to an observable market proxy for a risk-free rate, such as the current yield on a low-risk government bond in a currency consistent with that of the provision."

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?

1. Transition requirements – Proposed paragraph 94D and 94E of IAS 37

The IASB has proposed for the entity to apply:

- a modified retrospective approach for changes in accounting policy for costs included in the measurement of a provision (paragraph 94D); and
- a simplified retrospective approach for changes in accounting policy for determining discount rates (paragraph 94E).

We are concerned that the differing transition approaches for changes in accounting policy related to costs included in the measurement of a provision and changes in discount rates could cause confusion in the marketplace. Additionally, restating provisions for changes in accounting policy for determining discount rates may offer limited (if any) benefits when the same is not required for changes in accounting policy for costs included in the measurement of a provision. Therefore, we suggest for the IASB to consider adopting the same modified retrospective approach for both types of changes in accounting policy.

If the IASB retains the proposed simplified retrospective approach for changes in accounting policy for determining discount rates (paragraph 94E), we are concerned that the requirement to apportion the adjustment amount between the related asset and retained earnings could be difficult to understand, and the basis for the apportionment is unclear. Therefore, we suggest for the IASB to provide more clarity on the basis for the apportionment and include illustrative examples to aid understanding.

2. Effective date

Apart from noting that entities would require time and effort to prepare for the proposed amendments, including developing new or revised processes and controls, we have no further comments on factors that the IASB should consider in assessing the preparation time needed.

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?

1. Expansion of decision tree – Proposed new decision tree in Section B of the Guidance on implementing IAS 37

The IASB has proposed to replace the current decision tree (with associated supporting explanation) in Section B of the Guidance on implementing IAS 37 with a new three-part decision tree (with associated supporting explanation). The new three-part decision tree summarises the process of applying the three criteria for recognising a provision under the proposed amendments to IAS 37.

We agree that the proposed new three-part decision tree is more comprehensive. However, it would be easier to use if the three parts were combined into a single decision tree, as the current proposal makes them appear somewhat separate.

2. Proposed Illustrative Examples 5A and 5B in the Guidance on implementing IAS 37

Illustrative Example 5A and 5B illustrate the considerations relating to the provision for employee termination benefits.

We wish to highlight that paragraphs 165 to 168 of IAS 19 contain specific requirements relating to the recognition of liability for termination benefits, particularly regarding the timing of recognition of the provision. As this is relevant to Illustrative Examples 5A and 5B, we suggest that the IASB make reference to these paragraphs in IAS 19. This reference would mitigate the risk of preparers misunderstanding that the IAS 37 recognition requirements apply in isolation to termination benefits.

Illustrative Example 5B sets out considerations relating to provision for customer contract termination benefits.

We wish to highlight that the IFRS Interpretations Committee's agenda decision "Compensation for Delays or Cancellations (IFRS 15 *Revenue from Contracts with Customers*) [September 2019] had clarified that compensation for delays or cancellations, as described in the request, is variable consideration in the contract and should be accounted for in accordance with IFRS 15. We suggest for the IASB to amend the fact pattern in Illustrative Example 5B to remove references to customer contract termination benefits.

3. Proposed Illustrative Example 7 in the Guidance on implementing IAS 37

Illustrative Example 7 sets out considerations relating to provision for staff training costs. We note that the analysis for the "Obligation condition" refers to (i) the responsibility to comply with a financial services regulation, (ii) the provision of staff training services, and (iii) a contract with a provider of training services.

As the intention is to determine whether there is an obligation to provide training services, we suggest that the IASB clarify this in the introduction and analysis of the three conditions. Additionally, we suggest removing references to a contract for training services not yet entered into, as such contracts would be executory contracts which are outside the scope of IAS 37 unless they are onerous.

4. Proposed Illustrative Example 11A

Illustrative Example 11A sets out considerations relating to the provision for costs to replace the lining of the furnace.

We note that the contract in question is an executory contract. As the scope of IAS 37 specifically excludes the accounting of provisions resulting from executory contracts except where the contract is onerous. We suggest for the IASB to consider removing this Illustrative Example. If the IASB were to retain this example, we suggest for the IASB to make clear that executory contracts are out of scope of IAS 37.

5. Proposed Illustrative Example 11B

Illustrative Example 11B sets out considerations relating to the provision for costs of mandatory overhauls of aircrafts.

We wish to highlight that paragraph 14 of IAS 16 provides guidance on the accounting of major inspections of owned property, plant and equipment. As the conclusion in Illustrative Example 11B is consistent with paragraph 14 of IAS 16, we suggest that the IASB make the reference to IAS 16.

6. Proposed Illustrative Examples 13A to 13C in the Guidance on implementing IAS 37

One of the conditions supporting the present obligation recognition criterion is that the entity's obligation is a present obligation when the entity has taken specific or multiple actions. This is illustrated in examples 13A to 13C.

Notwithstanding the said examples, we understand that the scenarios in practice could be more complex. Hence, it would be useful if the IASB could provide more examples to aid entities in their assessment of the above condition as well as factors to be considered. For instance, when assessing the provision for property tax, some factors to be considered include:

- Whether the law considers the ownership of the asset throughout the year
- Whether there is an existing practice of negotiations between the seller and the buyer for compensation relating to the property
- Whether the law takes into account the duration of ownership
- Whether the tax is due on the first day vs last day of the assessment period
- Whether the tax is based on the value of the asset in a previous period(s)
- Whether the tax is based on the estimated gross annual rental income by the tax authority
- Whether the amount of tax reflects the condition of the asset throughout the year – e.g. if the tax is due on the first day of the annual period but the asset is subsequently damaged, then the amount of tax is reduced.

Additionally, we note that the conclusions for Illustrative Examples 13A to 13C and 14 focus on the accounting of provisions at the end of the annual reporting period. A key accounting consideration for levies is the accounting of such provisions at interim reporting periods – specifically, whether and how an entity recognises a provision and the related expense in the interim financial statements. It would be helpful if the IASB could provide guidance to these illustrative examples to this.

7. Proposed Illustrative Example 14 in the Guidance on implementing IAS 37

Illustrative Example 14 sets out considerations relating to the provision for the expenditure required to obtain and surrender enough positive credits to eliminate the negative credits for the reporting period. From the analysis for the "Past-event condition", it appears that this condition is <u>met over time</u> (i.e. the present obligation accumulates over time) as the entity produced vehicles with average fuel emissions higher than the government target. However, no reference is made to paragraph 14O of IAS 37 for this. We suggest that the IASB make this reference, as this would align with the analysis for "Past-event condition" in Illustrative Examples 13A and 13B.

8. Other comments

(i) Consistency of approach for the Illustrative Examples

Based on the proposed new decision tree in Section B1, it appears that when the obligation condition and transfer condition are not met, there is no need to assess if the past-event condition is met.

We note that the analysis in Illustrative Examples 6(a), 6(b), 7, 11A and 11B includes an assessment of all three conditions, even when the obligation condition or transfer condition are not met. However, the analysis in Illustrative Example 15 does not include the assessment for the past-event condition when the transfer condition is not met. We suggest that the IASB adopt a consistent approach for the decision tree and the Illustrative Examples.

(ii) Updating of Illustrative Examples 2 and 3 in IFRIC 12

We note that some entities have contractual obligations to maintain or restore assets that they operate but do not own, for instance, operators in service concession arrangements within the scope of IFRIC 12. Paragraph 21 of IFRIC 12 states that such contractual obligations shall be recognised and measured in accordance with IAS 37, and Illustrative Examples 2 and 3 in IFRIC 12 (paragraphs IE11 to IE 38) sets out considerations relating to the provision of resurfacing costs. It would be helpful if the IASB update the mentioned Illustrative Examples in IFRIC 12 to explain how the three conditions as proposed in this ED would apply to the obligations in question.

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

1. Joint and several liabilities

In this ED, the IASB has proposed to exclude the entity's non-performance risk from measurement of provisions under IAS 37. For situations where an entity is jointly and severally liable, the entity would recognise a provision for its own portion of the obligation(s) which excludes non-performance risk and disclose a contingent liability for the portion of the obligation(s) expected to be settled by other parties. The amount expected to be settled by other parties should take into account the non-performance risk of those parties.

We suggest for the IASB to make clear the above as we are concerned that entities may interpret the requirement to exclude non-performance risk to mean that they will not be required to provide for amounts that its co-obligors cannot pay.

2. Interaction with IFRS 9

In practice, there may be situations where a provision under IAS 37 is subsequently settled contractually.

We suggest for the IASB to clarify if such a provision will have to be accounted for under IFRS 9 or if there can be exceptions provided such that these provisions would not need to be remeasured even if a contract has been established.

3. Inconsistency in measurement bases in IAS 37

Although not covered in this ED, we would like to highlight an inconsistency in the measurement bases in IAS 37.

In our view, the measurement objective in IAS 37 is unclear and could be interpreted in more than one way. For instance, the provision estimated in accordance with paragraph 36 of IAS 37 would be based on the best estimate of expenditure. However, the same provision could also be determined based on the amount that an entity would rationally pay to transfer the obligation to a third party in accordance with paragraph 37 of IAS 37.

Thus, there are two different measurement bases – the earlier is based on an entity-specific value and the latter is based on a market-participant value. Such a difference would contribute to diversity in practice and non-comparability of financial performance and financial position among entities.

Additionally, a provision determined based on the amount that an entity would rationally pay to transfer the obligation to a third party in accordance with paragraph 37 of IAS 37 using a risk-free discount rate could contribute to an inconsistency with the fair value measurement of a liability under paragraph 42 of IFRS 13 which requires the fair value to reflect a non-performance risk including a credit risk.

Hence, we would suggest for the IASB to consider addressing the noted inconsistency.

Should you require any further clarification, please feel free to contact Ms Felicia Tay at felicia.tay@isca.org.sg or Ms Jezz Chew at jezz.chew@isca.org.sg.

Yours faithfully,

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