



Association pour la participation des
entreprises françaises à l'harmonisation
comptable internationale



Dr Andreas Barckow, Chairman,
International Accounting Standards Board,
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Dear Dr Barckow,

Exposure Draft: Provisions—Targeted Improvements

We welcome the opportunity to comment on this exposure draft (the ED), although we would have preferred more time to analyse all the implications of this complex and fundamental text, falling as it does in the busy year-end period of most of our member-companies.

We note that the reasons provided by the IASB for revisiting IAS 37 are as follows:

- Difficulties faced by preparers of financial statements in disentangling two distinct conditions within present obligation recognition criterion (paragraphs BC8–BC12);
- Stakeholder dissatisfaction with IFRIC 21 Levies, which interprets the present obligation recognition criterion (paragraphs BC13–BC14); and
- Difficulties in applying the requirements to laws and regulations with novel enforcement mechanisms or settlement options (paragraphs BC15–BC16).

Regarding the first objective, as preparers, we have been applying this standard since the transition to IFRS and have not encountered significant complexities in its implementation. We have developed operational accounting policies that are widely shared and well understood within our groups. When difficulties do arise, they are more a result of the complexity of certain cases rather than an inherent deficiency of the standard. We believe that the proposed changes to the definition of an obligation will not simplify implementation and, in view of the differences in interpretation of the proposals of the ED that already exist today (see response to Q1), will, on the contrary, introduce significant uncertainties.

Regarding IFRIC 21, we confirm that we were opposed to this interpretation as it overturned established accounting practices that had been in place for years without any questioning of their relevance, and the resulting representation of many taxes no longer makes any economic sense.

That being said, other solutions could have been explored to address these anomalies without risking collateral damage to other provisions, or alternatively, the status quo could have been maintained to avoid unnecessary adjustments to financial statements. Changing the accounting for certain taxes previously accounting for under IFRIC 21 twice in a few years may raise doubts about the quality of the whole IFRS framework.

Finally, regarding the third reason mentioned, related to recent fact patterns dealt with by IFRIC, it seems to us that there was no need for a fundamental modification of the standard and that these interpretations could simply have been incorporated as illustrative examples.

If you require any further information about our comments on the ED, please do not hesitate to contact us.

Yours sincerely,

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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 to 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).

First, we understand that the IASB found it simpler to break down the notion of an obligation into three conditions to be met, but we are not convinced that this facilitates the application of the standard, which, as mentioned in the introduction, has been applied since the transition to IFRS without any real difficulties.

Condition of Obligation

1. We are in favour of the clarifications provided regarding the obligation to have responsibility towards a third party,

In many examples, the IASB specifies that the government acts on behalf of other stakeholders, and we question the necessity of such a clarification and whether the conclusions would change in the absence of this precision [IE 2A: "The entity owes that responsibility to the country's government, which acts on behalf of society at large"].

2. Regarding the clarification on the existence of a mechanism, we also agree, but we consider that this is defined too vaguely with respect to constructive obligations. Also, in Example 2B, it is stated that an implicit obligation is created by two elements: the publication of a policy and past compliance with it by the company. It makes sense to us to reduce the mandatory consequences of announcements made by a company, and we propose that this be included in the definition of a constructive obligation in paragraph 14C(b) of the standard, or at least, that the text should specify that this past compliance with these commitments forms part of the concept of past practice as defined in paragraph 14F(b)
3. Finally, on the notion of obligation, we are somewhat sceptical about the scope of paragraph 14F(a)ii, which specifies that the economic consequences of not fulfilling the responsibility would be worse than the consequences of fulfilling it. We understand that this paragraph was added to reinforce the notion of "practical ability" and to dismiss extreme interpretations like "stopping activity" to conclude on the absence of an obligation. However, we have several concerns about this addition:
 - It could be interpreted very broadly and constrain entities to balance for each case the cost of fulfilling their obligation against the benefits of not fulfilling it. Beyond the moral

aspect of this assessment, it seems to add significant complexity to the implementation and may lead to the absence of provisions in cases that would clearly require them today. We are aware that some interpret this requirement to mean that if by ignoring a responsibility the entity will gain more economic benefits from its activity at large (as implied by the reasoning in example IE 14), then no obligation exists; others think that the notion of the consequences is limited to the amount of the penalty to be paid if the obligation is ignored. It would therefore be helpful if the Board were to define the scope of “economic consequences”.

- This “economic” analysis is not included in the notion of a constructive obligation, yet we see no reason for such differentiation. If we take Example 14, one could imagine that the entity might ultimately conclude that it would cost less to continue emitting more than its target instead of fulfilling its obligation to purchase carbon credits.
- Lastly, the IASB has modified examples in this sense but has reached the same conclusion regarding the existence or non-existence of a provision. The changes made are subtle and could undermine long-established conclusions in similar cases. For example, in Example 11B, the conclusion not to recognize a provision was historically based on the entity’s ability to avoid costs through future actions [because “no obligation exists to overhaul the aircraft independently of the entity’s future actions—the entity could avoid the future expenditure by its future actions, for example, by selling the aircraft”].
 - Even though the conclusion in the example remains the same, the reasoning has been significantly altered, and the IASB should draw much more attention to this aspect and not suggest that this clarification has no impact.
 - Furthermore, to reach the same conclusion as before, it seems that the IASB relies on fragile arguments that appear contradictory to other aspects of the standard. It is stated, for example, that the entity has not obtained the benefits, yet it has already used the aircraft for two years. This seems contradictory to the provisions on thresholds and the breakdown of an obligation into different actions. Some might consider that the use of the aircraft over two years constitutes an action that progressively leads to the obligation for maintenance.

Condition of Past Event

It seems to us that, in rectifying IFRIC 21, the IASB has unduly complicated the standard and made it quite uncertain in many cases. It is not so much the principle described in paragraph 14Q about the existence and timing of multiple actions leading to the generation of an obligation that poses an issue, but the application/interpretation of this by the IASB regarding taxes. Specifically, it seems that the arbitrary breakdown of taxes into multiple actions to fit the proposed model adds confusion and risks leading to conclusions that do not always make sense. We have had numerous discussions on several taxes, which show that there is currently no consensus on the interpretation of the text. Furthermore, there now seems to be confusion between an action triggering the obligation (the obligating event) and actions building the base of the evaluation.

As we had already explained with IFRIC 21, the drafting of the legislative texts governing these taxes often takes into account factors other than the real economic substance and primarily reflects budgetary constraints, non-retroactivity, and/or adoption timelines. [The mechanism of the legislation in general, and the identification of the "obligating event" that triggers the payments, in particular, have little to do with the economic substance of the entity's operations but are motivated largely by the authority's funding requirements and the constraints placed upon it by the constitution within which it functions.]

We believe that the IFRIC interpretation remains incorrect and that there is no need for a change in the standard to alter its conclusions, especially with the clarification made in paragraph 14F (a) ii.

A tax is generally based on three pillars:

- A scope of businesses involved: usually defined at a single point in time for simplicity.
- A tax base.
- A sanctioning action by law, generally involving the performance of an activity over a given period.
It seems dangerous to rely on the proposed provisions to extract "multiple actions" as defined by the standard.

Ex 13 B: although we believe that the conclusion regarding the recognition of a provision spread over the period is correct, we believe that the identification of the two 'actions' is erroneous. The legislator is simply seeking to tax banking activity and has taken as its scope the banks in existence on a given date, probably for the sake of administrative simplicity. The only action is therefore to carry out banking activities during the period.

Ex 13 A: here again, there is only one action, that of generating income over a given period. The triggering event on 01/01/n+1 is a purely legal formality, probably also motivated by administrative reasons or constraints on retroactivity. There is no need to identify two separate actions. The provision should naturally be built up gradually over the period.

Ex 13 C: once again, a single action sanctioned by the tax, which consists of operating or using fixed assets over a given period. Although the base is determined at a single date, the logic is to tax transactions carried out throughout the year using PPE.

Given these elements, we believe that the IASB could:

- Review the conclusions of IFRIC 21 without changing all the current provisions of IAS 37;
or
- Consider an alternative proposed by EFRAG¹, which is simpler and does not require such fundamental changes to IAS 37; or
- Do nothing, not even modify IFRIC 21, as businesses and the market have already adapted to these treatments (though still debatable).

¹ an approach under which recurring levies (also those only depending on holding specific assets or liabilities on a given date) would be considered a cost of doing business in a period (in which all of the necessary conditions for the levy would be met). Under this approach the past-event condition is considered met, and the resulting present obligation accumulates over that time.

Question 2—Measurement—Expenditure required to settle an obligation

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?

No specific comment on this proposal.

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 understand that the IASB has already studied and rejected arguments for a different rate from the proposed one, and we have no further comments to add. However, it is important that the IASB retains the following elements in the final version of the amendments:

- Paragraph 47b, which specifies that the discount rate may reflect, in addition to the risk-free rate provided in paragraph 47a, risks reflected in elements related to the amount or timing of the expenditures to be incurred.
- Paragraph 47A, which specifically excludes the non-performance risk from this rate.
- Paragraph BC82, which clarifies certain cases of adjustment with a preference for deleting the last sentence. We understand that the 2nd sentence of BC82 highlights that adjustments to the yield might be made ‘in some cases’. Hence, we do not see the reason why the IASB found it relevant to emphasize specifically, in the following sentence, that it does not expect ‘all’ entities to make this adjustment. How are we to understand this strong emphasis? We would have thought that this 2nd sentence was already circumscribed by the new paragraph 47A and the reference to the current paragraph 43. We suggest the IASB clarifies the objective of this sentence or how it will apply in practice.
- We also note that the guidance in paragraph 47 states that the discount rate is a pre-tax rate that reflects a risk-free rate adjusted for certain risks. Paragraph BC 81 states that the entity determines an appropriate risk-free rate to use as the discount rate or as the starting point for a credit-adjusted rate.

Question 4—Transition requirements and effective date

4(a) Transition requirements

We welcome the two exemptions to retroactive treatment provided for the discount rates and the costs included in the amount of a provision. However, regarding the discount rate, an example would be useful, as the wording of the proposed simplification is not clear, and the simplification is not immediately apparent. Additionally, we do not understand why one of the simplifications refers to the transition date while the other refers to the date of first application.

4(b) Effective date

Given the complexity of the proposals and the wide scope of operations affected by IAS 37, a two-year period seems to us to be a minimum.