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Chair

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Comments on the Exposure Draft (ED/2024/8)

Provisions – Targeted Improvements (Proposed amendments to IAS 37)

1. The Accounting Standards Board of Japan (“we”) welcome the opportunity to provide our comments on the International Accounting Standards Board (“the IASB”)’s Exposure Draft (ED/2024/8) *Provisions – Targeted Improvements (Proposed amendments to IAS 37)* (hereinafter referred to as “the ED”), issued in November 2024.
2. The following paragraphs summarise our main comments on the ED.

(Present Obligation Recognition Criterion – Identifying Actions that Meet the Past-Event Condition)

3. The ED proposes amendments to the recognition criterion of provisions in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* so that the requirements in IAS 37 align with *The Conceptual Framework for Financial Reporting* (hereinafter referred to as “the *Conceptual Framework*”) revised in 2018.
4. Paragraph 14Q of the ED states that there are situations where an entity has an obligation to transfer an economic resource only if it takes two (or more) separate actions. The ED does not describe how to identify each action in such situations, nor how to specify whether the action is taken at point-in-time or over time. In addition, as mentioned in the same paragraph, an entity will need to determine

whether it has no practical ability to avoid taking the second action (or all the remaining actions). However, such determination may be difficult depending on the specific facts and circumstances, as it may involve significant judgement.

5. With little concept or basis regarding how to identify the separate actions in the main body of the standard, we think that stakeholders are likely to rely on illustrative examples to justify their identification of the separate actions. Accordingly, the IASB should be careful in deciding what to include in the illustrative examples and how detailed each example should be. In addition, we acknowledge that some guidance is provided regarding when an entity has no practical ability to avoid the second action (or all the remaining actions) in paragraph 4.34 of the *Conceptual Framework* and paragraph 14F of the ED, but we think it may still be difficult to make judgements in specific cases.
6. Accordingly, we think that the proposals in the ED warrant further improvements, and if such improvements cannot be made, we think that it is worth considering retaining the requirements similar to the existing interpretations in IFRIC 21 *Levies*, which states that the past-event condition is met when the entity takes the last action.

(Present Obligation Recognition Criterion – Distinguishing between Transfer and Exchange under the Transfer Condition)

7. Paragraph 14L of the ED states that an obligation to exchange economic resources with another party is not an obligation to transfer an economic resource to that party unless the terms of the exchange are unfavourable to the entity. In this context, we think that there are situations where it would be difficult to distinguish between exchanging economic resources and transferring economic resources, because an exchange can be viewed as a two-way transfer and encompasses transfers as its components.
8. Accordingly, we think that the unit or the item that is subject to the transfer condition needs to be clarified. As part of that clarification, we think that it is at least helpful to explain that non-reciprocal transfers, where an entity receives nothing in return, such as the payments of levies or fines, are transfers of economic resources under the transfer condition.



9. For our comments on the specific questions in the ED, please see the Appendix of this letter.
10. We hope our comments are helpful for the IASB's consideration in the future. If you have any questions, please feel free to contact us.

Yours sincerely,

A handwritten signature in black ink that reads "Y. Kawanishi". The signature is written in a cursive, flowing style.

Yasunobu Kawanishi

Chair

Accounting Standards Board of Japan

Comments on Specific Questions in the ED

Our comments on the specific questions sought in the Exposure Draft (ED/2024/8) *Provisions—Targeted Improvements (Proposed amendments to IAS 37)* (hereinafter referred to as “the ED”) are as follows.

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. The following paragraphs in this Appendix provide our comments on the following proposals in the ED in Question 1.
 - (a) Updating 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* (hereinafter referred to as the *Conceptual Framework*) (paragraphs 10 and 14(a) of the ED, Appendix A of the ED)

- (b) Identifying three conditions within the present obligation recognition criterion (paragraphs 14A to 16 of the ED)
- (c) Adding requirements for threshold-triggered costs (paragraph 14P of the ED)
- (d) Improving the wording of the requirements for restructuring costs (paragraphs 72 to 81 of the ED)
- (e) Withdrawing IFRIC 6 and IFRIC 21 (paragraph 108 of the ED)

(Updating the definition of a liability in IAS 37 to align it with the definition in the *Conceptual Framework*)

2. We agree with the proposals.

(Identifying three conditions within the present obligation recognition criterion)

The transfer condition

- 3. Paragraph 14L of the ED states that an obligation to exchange economic resources with another party is not an obligation to transfer an economic resource to that party unless the terms of the exchange are unfavourable to the entity. In this context, we think that there are situations where it would be difficult to distinguish between exchanging economic resources and transferring economic resources, because an exchange can be viewed as a two-way transfer and encompasses transfers as its components.
- 4. Illustrative Example 15 of the ED identifies an obligation to reduce emissions as an obligation to exchange economic resources because an entity will receive other economic resources, such as property, plant and equipment. However, the obligation may be identified as a transfer of economic resources if we focus on the entity's use of such resources to perform its obligation declared in its statement. Accordingly, we think that the unit or the item that is subject to the transfer condition needs to be clarified.
- 5. As part of that clarification, we think that it is at least helpful to clarify that non-reciprocal transfers, where an entity receives nothing in return, such as the payments of levies or fines, are transfers of economic resources under the transfer condition.
- 6. We note that Illustrative Example 15 of the ED refers to the obligation to offset the remaining emissions, stating, "The entity will be required to buy and retire carbon

credits without receiving any economic resources in exchange”, which may imply that carbon credits are not economic resources. In this regard, we think that carbon credits acquired in exchange for consideration are indeed economic resources, and the wording should be revised to avoid the misunderstanding that carbon credits are not economic resources. Specifically, we propose the following wording (proposed new text is underlined and proposed deletion is struck through):

“The entity will be required to ~~buy and~~ retire carbon credits it had purchased in exchange for consideration, without receiving any economic resources in exchange.”

The past-event condition

7. Paragraph 14N of the ED states that an entity will or may have to transfer economic resources as a consequence of having obtained specific economic benefits or having taken a specific action. Regarding the identification of actions, the ED notes the causal relationship between identified actions and the transfer of economic resources, stating that the former causes the latter.
8. Paragraph 14Q of the ED, which relates to this relationship, states that there are situations where an entity has an obligation to transfer economic resources only if it takes two (or more) separate actions. In this context, we think there are two problems:
 - (a) The ED does not describe how to identify each action in such situations, nor how to specify whether the action is taken at point-in-time or over time.

We are concerned that this may give rise to inconsistent application of the requirements.
 - (b) As mentioned in the same paragraph, an entity will need to determine whether it has no practical ability to avoid taking the second action (or all the remaining actions). Such determination may be difficult depending on the specific facts and circumstances, as it may involve significant judgement.

For example, such determination may be difficult when the time between the first action and the second action (or the remaining actions) is long.
9. Regarding the first problem in the previous paragraph, we acknowledge that paragraph BC36 of the ED states that management would reach a conclusion by assessing all the relevant facts of the mechanism that has created the obligation.

10. However, with little concept or basis regarding how to identify the separate actions in the main body of the standard, we think that stakeholders are likely to face difficulty in identifying the actions and thus are likely to rely on illustrative examples to justify their identification of the separate action. In this context, we observe the following problems related to the new illustrative examples in the ED:

- (a) Comparing Illustrative Examples 13A, 13B and 13C, our observation is that these examples use the factors to determine the amounts of levies to identify the relevant actions that lead to the existence of the levies. For example, Illustrative Example 13A identifies generating revenue in the market in 20X0 as the first action. The factor that affects the measurement of the entity's obligation apparently is affecting the timing of recognition. However, there is no notable rationale to identify revenue generation as the first action, other than the stakeholders' view noted in paragraph BC14 of the ED, stating that the substance of a recurring levy is that the entity is paying to operate over a period, and that this substance would be more faithfully represented if entities recognised the expense systematically over that period. We are concerned that there is confusion between when to recognise a liability and how to measure that liability, which in principle should be clearly distinguished.
- (b) Considering the outcomes of Illustrative Examples 13B and 13C are significantly different despite the similarity in the underlying conditions, it is difficult to identify actions in cases where the levy is a "hybrid" of the two, for example, when the levy includes a fixed portion and a variable portion (for example, proportional to the amount of revenue).
- (c) Illustrative Example 13B does not refer to the change in the amount in the statement of financial position during the period as a factor to identify the first action, even though such amount affects the amount of the levy, but this example uses the length of a reporting period, which is a factor that affects the amount of the levy, to identify the first action (operating in its current annual reporting period). On the other hand, Illustrative Example 13A also uses the amount of revenue to identify the first action (generating revenue), which can also affect the amount of items in the statement of financial position. As a result, we are concerned that how to identify the separate actions apparently are inconsistent among the illustrative examples.

11. Accordingly, the IASB should be careful in deciding what to include in the illustrative examples and how detailed each example should be. From this

perspective, we suggest removing Illustrative Example 13C, which is not carried over from IFRIC 21 and the outcome of identifying actions is significantly different from Illustrative Examples 13A and 13B.

12. Regarding the problem mentioned in paragraph 8(b) of this Appendix, we acknowledge that some guidance is provided regarding when an entity has no practical ability to avoid the second action (or all the remaining actions) in paragraph 4.34 of the *Conceptual Framework* and paragraph 14F of the ED, such that the economic consequences for the entity of not discharging the responsibility are expected to be significantly worse than the cost of discharging it. However, we think that it may still be difficult to make judgements in specific cases.
13. Accordingly, we think that the proposals in the ED warrant further improvements, and if such improvements cannot be made, we think that it is worth considering retaining the requirements similar to the existing interpretations in IFRIC 21, which states that the past-event condition is met when the entity takes the last action.

(Adding requirements for threshold-triggered costs)

14. We agree with paragraph 14P of the ED which states that the action that meets the past-event condition is the activity that contributes to the total activity on which the amount of the transfer is assessed in the situations where an entity has an obligation to transfer economic resources only if a measure of its activity in a period exceeds a specific threshold.
15. We think, however, that it should be made clear that the identified action in applying paragraph 14P of the ED is taken over time and that the resulting present obligation accumulates over time in accordance with paragraph 14O of the ED.

(Improving the wording of the requirements for restructuring costs)

16. Paragraph 72 of the ED, which refers to the costs of a restructuring, proposes replacing the term “a constructive obligation” with “a present obligation.” As a consequence, legal obligations related to restructuring could be included in the scope of the assessment of paragraph 72(a) and (b) of the ED.
17. We are concerned with this consequence and think that legal obligations should be excluded from the scope of the assessment. This is because the terms and conditions of the obligations are described in the laws or agreements, and it is reasonable to expect that an entity has already considered such terms and

conditions to determine whether it should recognise relevant liabilities considering the possibilities of whether such conditions are met.

18. In this regard, paragraph 80 of the ED (which is substantially the same as the existing requirement) explains that a restructuring provision includes present obligations for the direct expenditures arising from the restructuring which are (a) necessarily entailed by the restructuring and (b) not associated with the ongoing activities of the entity. Therefore, it seems that the above-mentioned liabilities are already excluded from a restructuring provision. However, we note that there are some potential overlaps between an obligation that arises from a restructuring and one that arises from ongoing activities. For example, the employee termination benefits contractually required to pay to employees providing services for at least a year described in Illustrative Example 5A may apply to restructuring as well as to ongoing activities. Accordingly, we think that there is a need for clarification.

(Withdrawing IFRIC 6 and IFRIC 21)

19. We basically agree with the proposals, except for the comments made in paragraph 13 of this Appendix that it may be worth considering retaining the requirements similar to the existing interpretations in IFRIC 21, which states that the past-event condition is met when an entity takes the last action, if improvements to the proposals in the ED cannot be made.

Question 2—Measurement—Expenditure required to settle an obligation
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The IASB proposes to specify the costs an entity includes in estimating the future expenditure required to settle an obligation (paragraph 40A).
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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?

20. We agree with the proposals.

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?

(Discount rates)

21. There are two factors to determine the present value of an item, namely the estimates of undiscounted future cash flows (a factor in the numerator) and the discount rate (a factor in the denominator). If the ED were to prescribe that an entity discounts the future expenditure required to settle an obligation at a rate that reflects the time value of money with no adjustment for non-performance risk, a question as to whether the entity should include the non-performance risk in estimating the undiscounted future cash flows remains. Accordingly, we think that the IASB should also address this question.
22. We think that there are two approaches regarding how to estimate undiscounted future cash flows. One approach would reflect the perspective of market participants and the other approach would reflect the entity’s own estimates of its expenditures. We think that the latter approach, which excludes non-performance risk of the entity, is reasonable for the asset decommissioning obligations which often require present value calculations. This is because undiscounted future cash flows from the perspective of market participants are usually not objectively determined for these obligations and, even if an entity attempts to estimate undiscounted future cash flows from such perspective, the amounts are unlikely to be significantly different from the entity’s own estimates of its expenditures.

(Disclosure requirements)

23. Paragraph 85(d) of the ED proposes that an entity disclose the approach used to determine the discount rate used in measuring a provision. Paragraph BC85 of the ED states that the proposal acknowledges that entities could use various approaches in determining an appropriate risk-free rate and that information about the approach used would enhance comparability. However, we are also aware that paragraph BC81(a) of the ED states that practice to determine an appropriate risk-free discount rate is already well-established without guidance in IAS 37, and we think that the disclosure of the approach is unnecessary if such a proposal is merely intended to disclose the approach to determine the risk-free discount rate.

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)

24. We basically agree with the proposals.
25. We note that different wordings are used to describe the discount rate used to estimate the amount that would have been included in the cost of the related asset when the provision first arose, and the IASB should clarify whether the ED intended to mean the same as that in IFRS 1:

- (a) Paragraph D21(b) of IFRS 1 *First-time Adoption of International Financial Reporting Standards*,

“its best estimate of the historical risk-adjusted discount rate(s) that would have applied for that liability over the intervening period”

- (b) Paragraph 94E(b)(i) of the ED

“the current discount rate(s) ... used in measuring the provision”

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?

26. We agree with the proposal to expand the decision tree in Section B.
27. We agree with the proposals in illustrative examples to Section C except for those we comment on the application of the past-event condition in paragraphs 6, 10 and 11 of this Appendix.

Question 7—Other comments

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

(Consequential amendment to IFRS 3)

28. The ED proposes to amend the requirements supporting the present obligation recognition criterion in IAS 37, to align them with the *Conceptual Framework*.

The ED also proposes to withdraw IFRIC 21. These amendments would eliminate the inconsistency between the recognition principle in IFRS 3 *Business Combinations* and the present obligation recognition criterion of IAS 37.

29. On the other hand, the ED proposes that an entity discount the provision at a rate that reflects current market assessments of the time value of money, represented by a risk-free rate, with no adjustment for non-performance risk. This may create another inconsistency between the proposal and the measurement principle in IFRS 3, which requires an entity to allocate the cost of a business combination by recognising the acquiree's identifiable liabilities assumed at their fair values at the acquisition date.
30. Accordingly, we think that IFRS 3 should include an exception to its measurement principle that an entity would discount the provision at a rate that excludes non-performance risk of the entity so that it aligns with subsequent measurement. As a consequence, no gains or losses due to the difference in the discount rates (so called Day 2 gains or losses) would arise.

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