IFRS Accounting

Staff paper

Agenda reference: 22B

IASB® meeting

Date	**September 2025**
Project	**Provisions—Targeted Improvements**
Topic	**Discount rates—interaction with IFRS 3**
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Purpose of the session

1. The International Accounting Standards Board (IASB) published Exposure Draft *Provisions—Targeted Improvements* (Exposure Draft) in November 2024, with a comment deadline of 12 March 2025. The Exposure Draft proposes amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

2. At its June 2025 meeting, the IASB discussed feedback on the Exposure Draft proposals. Agenda Paper 22E for that meeting summarised feedback on proposals relating to the discount rate an entity uses in measuring a provision.

3. At their July 2025 meeting, members of the Accounting Standards Advisory Forum (ASAF) provided their views on how the IASB should move forward in the light of that feedback.

4. At this meeting, we will ask the IASB to redeliberate the discount rate proposals in the light of the feedback in comment letters and from ASAF members.

5. This paper asks for decisions on an unintended consequence of the discount rate proposals—namely, the 'day-two' adjustments that could arise from the interaction between IAS 37 (if amended as proposed) and IFRS 3 *Business Combinations*.

Staff recommendations

6. We recommend that the IASB add to IFRS 3 an exception to its initial measurement principle that:

   (a) applies to provisions (other than contingent liabilities) within the scope of IAS 37; and

   (b) requires an acquirer to measure these provisions at the acquisition date in accordance with the measurement requirements in IAS 37, instead of at their acquisition date fair values.

Structure of this paper

7. This paper sets out:

   (a) background information—the Exposure Draft proposals and IFRS 3 requirements (paragraphs 8–24);

   (b) a summary of feedback in comment letters and from ASAF members (paragraphs 25–27);

   (c) our analysis of factors to consider in deciding whether and how to eliminate ‘day-two’ adjustments (paragraphs 29–33); and

   (d) our recommendation and question for the IASB (paragraph 34).

Exposure Draft proposals and IFRS 3 requirements

Exposure Draft proposals

8. IAS 37 requires an entity to measure a provision at the best estimate of the expenditure required to settle its present obligation, and to discount that expenditure to its present value if the time value of money is material. IAS 37 does not specify whether the discount rate(s) used should reflect the risk that the entity will not settle the obligation (non-performance risk).

9. The Exposure Draft proposes to specify that the discount rate(s) used should exclude the effect of non-performance risk.

IFRS 3 general measurement principles

10. When an entity acquires a business, it measures the assets it acquires and liabilities it assumes by applying the measurement requirements in IFRS 3. The general measurement principles in IFRS 3 are that an entity measures assets and liabilities:

    (a) *initially*: at their acquisition-date fair values[1]; and:

    (b) *subsequently*: in accordance with other applicable IFRS Accounting Standards for those items[2].

11. Paragraph 42 of IFRS 13 *Fair Value Measurement* explains that the fair value of a liability:

> …reflects the effect of non-performance risk. Non-performance risk includes, but may not be limited to, an entity's own credit risk (as defined in IFRS 7 *Financial Instruments: Disclosures*). Non-performance risk is assumed to be the same before and after the transfer of the liability.

1 Paragraph 18 of IFRS 3.

2 Paragraph 54 of IFRS 3.

Consequences of the general measurement principles for provisions

12. The general measurement principles in IFRS 3 apply to provisions assumed in a business combination. Consequently, an entity measures a provision:

    (a) *initially:* at its acquisition date fair value. The fair value is estimated using a discount rate that *includes* the effect of non-performance risk.

    (b) *subsequently:* in accordance with IAS 37. If IAS 37 is amended as proposed, it will require an entity to use a discount rate that *excludes* the effect of non-performance risk.

13. The difference in the initial and subsequent measurement requirements would result in a 'day-two' credit to the measure of the provision. If the provision relates to the cost of decommissioning an item of property, plant and equipment (PPE), the corresponding debit is usually added to PPE. Otherwise, it might be debited to the statement of profit or loss, resulting in the recognition of a day-two loss.

Exceptions to the general measurement principles for some types of assets and liabilities

14. IFRS 3 contains exceptions to its general measurement principles to prevent day-two adjustments for some types of assets and liabilities. Most of these exceptions are to the *initial* measurement principle. Typically, the exception is given if the other IFRS Accounting Standard applicable to the asset or liability requires a current value measure other than fair value. The exception requires the acquired asset or liability to be measured at the acquisition date in accordance with measurement requirements in the other IFRS Accounting Standard, instead of at fair value.

15. From its issuance, IFRS 3 has provided initial measurement exceptions for several types of assets and liabilities, including deferred tax assets and liabilities, employee benefit obligations, share-based payment liabilities and equity instruments, indemnification assets and assets held for sale.

16. The IASB has since added further initial measurement exceptions for:

    (a) lessee right-of-use assets and lease obligations within the scope of IFRS 16 *Leases*; and

    (b) insurance contract assets and liabilities within the scope of IFRS 17 *Insurance contracts*.

17. The IASB is in the process of balloting a new IFRS Accounting Standard for regulatory assets and regulatory liabilities. The prospective new Standard will include a consequential amendment to IFRS 3 to add another initial measurement exception, this time for regulatory assets and regulatory liabilities.

Previous consideration of a measurement exception for provisions

18. Day-two adjustments already arise for some provisions assumed in a business combination because some entities already apply IAS 37 with a policy of discounting provisions at a rate that excludes the effect of non-performance risk.

19. When the IASB was conducting its post-implementation review of IFRS 3, some stakeholders suggested adding a measurement exception to IFRS 3 to eliminate these day-two adjustments. However, other stakeholders said the adjustments were not a major problem in practice because the provisions affected are usually asset decommissioning provisions. Adjustments relating to asset decommissioning provisions are usually debited to PPE in the statement of financial position and therefore usually have no immediate effect on the statement of profit or loss.

20. Consequently, the IASB took no action as a result of the post-implementation review, and it was not asked to discuss the interaction of IAS 37 and IFRS 3 during the development of the Exposure Draft proposals.

Other IFRS 3 requirements for obligations within the scope of IAS 37

21. The difference between IFRS 3 and IAS 37 measurement requirements for *provisions* is not the only difference between the requirements in IFRS 3 and those in IAS 37. Another difference lies in the recognition requirements for some types of *contingent liabilities*—namely present obligations for which an outflow of resources is not probable (for example, guarantees that are unlikely to be called upon).

22. IAS 37 *prohibits* recognition (requires only disclosure) of such contingent liabilities. In contrast, IFRS 3 *requires* recognition of those whose fair value can be measured reliably. It requires acquirers to measure these contingent liabilities:
    (a) *initially*: at fair value; and
    (b) *subsequently*: at the higher of:
        (i) the amount initially recognised (less, if appropriate, cumulative income recognised applying the principles of IFRS 15 *Revenue from Contracts with Customers*); and
        (ii) the amount that would be recognised applying IAS 37.[3]

23. The ‘amount that would be recognised applying IAS 37’ becomes higher than the ‘amount initially recognised’ if the likelihood of an outflow of resources increases after the acquisition date to the point that an outflow becomes probable (or, in simple terms, if the contingent liability ‘turns into’ a provision). The ‘IAS 37 if higher’ requirement ensures that, in such circumstances, the contingent liability:
    (a) is re-measured to reflect the increasing likelihood of an outflow; and
    (b) is measured on the same basis as any other provision.

24. Any amendment the IASB were to make to IFRS 3 to eliminate day-two adjustments for provisions would have to work in harmony with IFRS 3 recognition and measurement requirements for contingent liabilities.

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3 Paragraphs 23 and 56 of IFRS 3.

Feedback in comment letters and from ASAF members

25. Many respondents to the Exposure Draft—and five ASAF members—expressed concern that the requirements proposed in the Exposure Draft would lead to entities recognising day-two adjustments, including day-two losses, for provisions assumed in a business combination.

26. These stakeholders said recognising day-two losses would not provide relevant information to users of financial statements. They asked the IASB take action to prevent these losses:

    (a) some respondents and the ASAF members commenting suggested providing an exception to the *initial* measurement principle in IFRS 3—so that at the date of acquisition, a provision assumed in a business combination would be measured applying the requirements of IAS 37, not at fair value. These respondents included six national standard-setters (in Asia-Oceania and Europe), four accountancy bodies (in Asia-Oceania and Europe), three accounting firms, a preparer group (in Europe) and a securities regulator group (global).

    (b) a few other respondents suggested the opposite—providing an exception to the *subsequent* measurement principle in IFRS 3 or allowing an accounting policy choice in IAS 37—so that after the date of acquisition, a provision assumed in a business combination would continue to be measured at fair value, not by applying the requirements of IAS 37. These respondents included two national standard-setters (in Europe), an accounting professional body (in Asia-Oceania) and a national insurance industry group (in Europe). The respondents did not give reasons for suggesting a subsequent measurement exception instead of the more typical initial measurement exception.

27. A few respondents said that, if the IASB accepts day-two adjustments as a consequence of the new requirements, it should, at a minimum, acknowledge this fact in the Basis for Conclusions and provide guidance or an illustrative example. These respondents included three accounting firms, two national standard-setters (in Europe), an accounting professional body (in Asia-Oceania), and a group representing securities regulators.

28. They suggested clarifying whether and how day-two adjustments should be reflected:

    (a) in profit or loss; or

    (b) as an adjustment to the carrying amount of a related asset. For example, if the related asset is a revalued item of PPE, should the acquisition cost or revaluation surplus/deficit be adjusted?

Staff analysis

Should the IASB amend IAS 37 as part of this project?

29. In response to stakeholders' concerns about day-two adjustments for provisions, the IASB could:

    (a) take no action as part of this project; or

    (b) amend IFRS 3 to prevent such adjustments.

30. In favour of taking no action as part of this project, it could be argued that:

(a) day-two adjustments arising for provisions do not cause significant problems in practice because they usually affect only the statement of financial position, not the statement of profit or loss (as explained in paragraph 19 of this paper).

(b) adding a measurement exception for provisions to IFRS 3 would add complexity to that Standard, especially because the IASB would need to structure the exception to work in harmony with the recognition and subsequent measurement requirements for contingent liabilities (as explained in paragraphs 21–24).

(c) IFRS 3 now contains many exceptions to its recognition and measurement principles—especially to its initial measurement principle (as explained in paragraphs 14–17). The growing number of exceptions to that principle perhaps suggests a need to reconsider the principle, rather than to add more exceptions. Such a review would be beyond the scope of this project.

31. Alternatively, in favour of amending IFRS 3 to eliminate day-two adjustments for provisions, it could be argued that:

(a) some day-two adjustments for provisions would affect the statement of profit or loss—for example, adjustments relating long-term litigation liabilities or to obligations to decommission fully-depreciated PPE. Furthermore, day-two adjustments are undesirable even if they affect only the statement of financial position—they portray a change in an entity's assets or liabilities that does not represent an economic change. Consequently, as stakeholders said, day-two adjustments do not provide relevant information to users of financial statements.

(b) at present, some entities applying IAS 37 use discount rates that include the effect of non-performance risk, and thus can avoid day-two adjustments. This will no longer be the case if IAS 37 is amended to prohibit the use of such rates.

(c) adding a measurement exception for provisions would not necessarily add significant complexity to IFRS 3. For the new exception to work in harmony with the requirements in IFRS 3 for some contingent liabilities, it would be necessary only to restrict the scope of the new exception, so that it excludes these contingent liabilities—as illustrated in our drafting suggestion set out in Appendix B to this paper. Furthermore, a decision tree could be added to IFRS 3 to help readers navigate the requirements. A simple decision tree is illustrated in Appendix A to this paper.

(d) even if the IASB were to decide at a future date to undertake a review of the measurement principles in IFRS 3, that review would take time to complete. Day-two adjustments for provisions could be avoided in the meantime by adding another exception to IFRS 3 as part of this project to amend IAS 37.

How should the IASB eliminate day-two adjustments?

32. As explained in paragraph 26 of this paper, some stakeholders suggested two alternative ways of eliminating day two adjustments:

(a) most suggested adding an exception to the *initial* measurement principle in IFRS 3 (see paragraph 26(a)). The exception could require an acquirer to measure provisions assumed in a business combination in accordance with the measurement requirements in IAS 37, instead of at fair value.

(b) a few suggested adding an exception to the *subsequent* measurement principle in IFRS 3 (see paragraph 26(b)). The exception could require an acquirer to continue measuring a provision assumed in a business combination at fair value after initial recognition.

33. An *initial* measurement exception could have advantages over a *subsequent* measurement exception:

(a) an initial measurement exception could result in more comparable and understandable information about provisions. With an initial measurement exception, an entity would measure all its provisions using the same measurement basis (that required by IAS 37). With a subsequent measurement exception, an entity would measure its provisions using two different measurement bases (fair value or IAS 37), depending on whether the provisions have been assumed in a business combination or incurred in another way.

(b) for preparers of financial statements, the costs of applying an initial measurement exception could be lower than the costs of applying a subsequent measurement exception. Provisions affected (those for which the effect of discounting is material) are typically long-term. An entity applying a subsequent measurement exception might have to continue accounting for provisions assumed in a business combination separately from other provisions for many years or even decades.

(c) a subsequent measurement exception might require more extensive changes to IFRS 3 than an initial measurement exception. The IASB would need to consider whether to also amend the subsequent measurement requirements for contingent liabilities. An amendment to those requirements would be needed to maintain consistency between the subsequent measurement requirements for provisions and those for contingent liabilities that 'turn into' provisions after the acquisition date (as described in paragraph 23).

(d) as explained in paragraphs 14–17, the IASB has used initial measurement exceptions, rather than subsequent measurement exceptions, to prevent day-two adjustments for other types of assets and liabilities. Taking the same approach for provisions could minimise the complexity that another measurement exception would add to IFRS 3.

Staff recommendation

34. For the reasons in paragraphs 31 and 33, we recommend that the IASB add to IFRS 3 an exception to its initial measurement principle that:

    (a) applies to provisions (other than contingent liabilities) within the scope of IAS 37; and

    (b) requires an acquirer to measure these provisions at the acquisition date in accordance with the measurement requirements in IAS 37, instead of at their acquisition date fair values.

35. To support our analysis and recommendations:

    (a) Appendix A contains a decision tree showing how an entity would determine whether and how to apply our recommended exception for provisions alongside the existing requirements for contingent liabilities; and

    (b) Appendix B illustrates possible wording for the recommended exception and other minor amendments to IFRS 3 that would be required to add the exception.

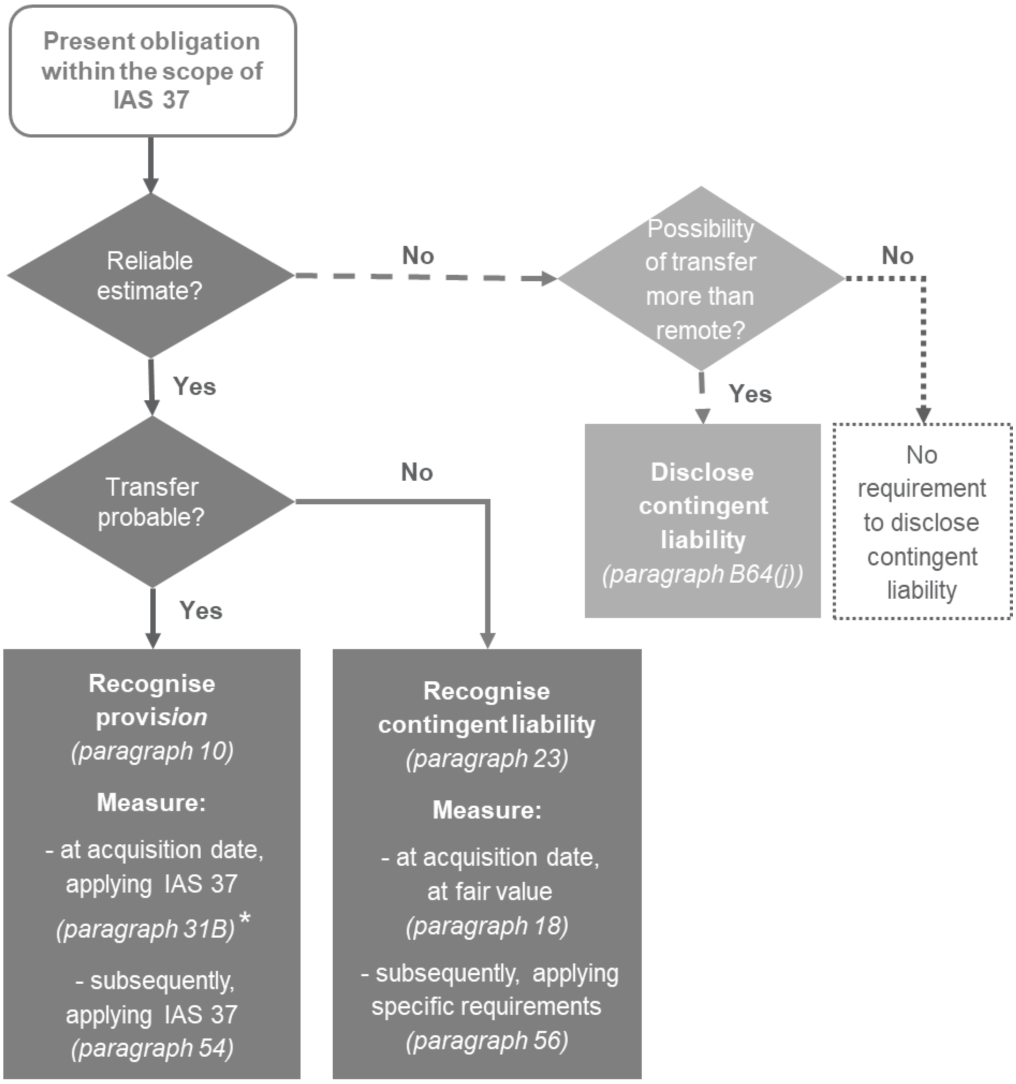
Question for the IASB

Discount rates—interaction with IFRS 3
Do you agree with our recommendation in paragraph 34?

Appendix A—Decision tree

A1. This decision tree shows how an entity could apply the requirements of IFRS 3 *Business Combinations* to obligations within the scope of IAS 37 if the IASB adds the initial measurement exception recommended in this paper.

A2. The reference to paragraph 31B is to a paragraph that could be added to IFRS 3 to create that exception. Other references are to existing paragraphs of IFRS 3.



* A new paragraph that would be added to IFRS 3 if the IASB amends IFRS 3 as recommended in this paper.

Appendix B—Illustrative drafting

B1. This appendix illustrates how the IASB could draft an amendment to IFRS 3 *Business Combinations* to add the initial measurement exception recommended in this paper. The insertions and deletions required for this amendment are marked up in **red font**.

B2. Insertions and deletions marked up in black font are other amendments that the IASB proposes to make to IFRS 3 as a consequence of this project—as set out in Appendix B to the Exposure Draft *Provisions—Targeted Improvements*. For further explanation of these other amendments, see paragraphs BC107–BC110 of the Basis for Conclusions on the Exposure Draft.

IFRS 3 *Business Combinations*

Paragraphs 21, 22 and 23 and the subheading after paragraph 21 are amended. Paragraphs 21A–21C and the subheading before paragraph 21A are deleted. Paragraph <u>31B, the subheading before paragraph 31B and paragraph</u> 64S ~~is~~ <u>are</u> added. New text is underlined and deleted text is struck through.

…

The acquisition method

…

Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

…

Measurement principle

18 **The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.**

…

Exceptions to the recognition or measurement principles

21 This IFRS provides limited exceptions to its recognition and measurement principles. Paragraphs <u>22</u>~~21A–~~~~31A~~<u>31B</u> specify both the particular items for which exceptions are provided and the nature of those exceptions. The acquirer shall account for those items by applying the requirements in paragraphs <u>22</u>~~21A–~~~~31A~~<u>31B</u>, which will result in some items being:

(a) recognised either by applying recognition conditions in addition to those in paragraphs 11 and 12 or by applying the requirements of other IFRSs, with results that differ from applying the recognition principle and conditions.

(b) measured at an amount other than their acquisition-date fair values.

Exception ~~Exceptions~~ to the recognition principle

~~Liabilities and contingent liabilities within the scope of IAS 37 or IFRIC 21~~

21A–21C [Deleted]

~~21A Paragraph 21B applies to liabilities and contingent liabilities that would be within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or IFRIC 21 *Levies* if they were incurred separately rather than assumed in a business combination.~~

~~21B The *Conceptual Framework for Financial Reporting* defines a liability as 'a present obligation of the entity to transfer an economic resource as a result of past events'. For a provision or contingent liability that would be within the scope of IAS 37, the acquirer shall apply paragraphs 15–22 of IAS 37 to determine whether at the acquisition date a present obligation exists as a result of past events. For a levy that would be within the scope of IFRIC 21, the acquirer shall apply IFRIC 21 to determine whether the obligating event that gives rise to a liability to pay the levy has occurred by the acquisition date.~~

~~21C A present obligation identified in accordance with paragraph 21B might meet the definition of a contingent liability set out in paragraph 22(b). If so, paragraph 23 applies to that contingent liability.~~

Contingent liabilities and contingent assets

22 IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* defines a contingent liability as:

(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not probable that the entity ~~an outflow of resources embodying economic benefits~~ will be required to transfer an economic resource to settle the obligation; or

(ii) the amount of the obligation cannot be measured with sufficient reliability.

23 The acquirer shall recognise as of the acquisition date a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably. Therefore, contrary to paragraphs 14(b), 23, 27, 29 and 30 of IAS 37, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that the entity ~~an outflow of resources embodying economic benefits~~ will be required to transfer an economic resource to settle the obligation. Paragraph 56 of this IFRS provides guidance on the subsequent accounting for contingent liabilities.

23A IAS 37 defines a contingent asset as 'a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity'. The acquirer shall not recognise a contingent asset at the acquisition date.

…

Exceptions to the measurement principle

…

Provisions

31B The measurement principle in paragraph 18 applies to contingent liabilities recognised in accordance with paragraph 23, but not to other provisions within the scope of IAS 37. The acquirer shall measure these other provisions in accordance with the measurement requirements in paragraphs 36–52 of IAS 37.

…

Effective date and transition

Effective date

…

64S *Provisions—Targeted Improvements*, issued in [Month, Year], which amended IAS 37, also amended paragraphs 21, 22 and 23 of this Standard, ~~and~~ deleted paragraphs 21A–21C and added paragraph 31B. An entity shall apply the amendments to this Standard when it applies the amendments to IAS 37.