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Project **Liabilities—amendments to IAS 37**

Topic **Summary of decisions reached since publishing exposure draft**

In June 2005, the Board published for comment an Exposure Draft of Proposed Amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

This appendix is a staff summary of the tentative decisions that the Board has reached since then, in the light of comments received. It lists all decisions that either reaffirm or change the exposure draft proposals.

The Board discussed some topics at several meetings and modified its decisions as the discussions progressed. This appendix excludes initial decisions that the Board modified at a later meeting.

The decisions are tentative. Tentative decisions do not change existing requirements. Decisions become effective only when the Board has incorporated them in a new or amended standard.

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1 Format and scope

Topic	Tentative decision	Comparison with exposure draft proposals
<p>1.1 Format</p>	<p>The output of the project should be a new IFRS, not an amended version of IAS 37. (September 2009)</p>	<p>The Board formatted the exposure draft as an amended version of IAS 37. However, the amendments were too extensive to be marked in the draft.</p> <p>The change will affect only the layout of the standard. It will not affect the requirements, nor significantly affect the way in which the requirements are expressed.</p>
<p>1.2 Scope</p>	<p>The revised IAS 37 should apply to all liabilities not within the scope of other standards.</p> <p>The standard should clarify explicitly that performance obligations measured applying IAS 18 <i>Revenue</i> on the basis of consideration received (deferred revenue) are not within the scope of the revised IAS 37.</p>	<p>No change.</p> <p>Clarifies a point that was implicit in the exposure draft.</p>

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2 Liability definition

Topic	Tentative decision	Comparison with exposure draft proposals
2.1 Contingent liability	The revised IAS 37 should eliminate the notion of a ‘contingent liability’. (July 2006)	No change.
2.2 ‘Expected to result in an outflow ... of resources...’	The revised IAS 37 should clarify the meaning of the term ‘expected’ in the definition. The term does not imply that there must be a particular degree of certainty that an outflow of benefits will occur before an item meets the definition of a liability. Present obligations that are capable of resulting in an outflow of resources meet the definition of a liability, even if the likelihood of an outflow is low. (May 2006)	This was not explicit in the exposure draft. But it was implicit in the discussion of stand-ready obligations.
2.3 ‘Present obligation’	<p>To emphasise the differences between liabilities and business risks, and to clarify the definition of a constructive obligation, the revised standard should state that:</p> <ul style="list-style-type: none"> - an obligation exists when an entity has a duty or responsibility to act or perform in a particular way - the duty or responsibility is to another party - and exists independently of future events. (July 2007) <p>The exposure draft described a present obligation as something that the entity has ‘little, if any, discretion to avoid settling’. This phrase is ambiguous and difficult to apply. The staff should consider whether to retain the phrase in the revised standard and, if so, where to position it. (July 2007)</p>	<p>The redrafting will change the emphasis from ‘little if any discretion to avoid’ to ‘duty or responsibility to perform’. It addresses commentators’ concerns that the former phrase is ambiguous.</p> <p>The phrase ‘duty or responsibility to act or perform in a particular way’ was not used in the exposure draft. But it is the phrase used to describe an obligation in paragraph 60 of the <i>IASB Framework</i>. So it is not new.</p>

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<p>2.4</p> <p>Distinguishing liabilities from business risks.</p>	<p>The revised IAS 37 should include further guidance clarifying that:</p> <ul style="list-style-type: none"> - the existence of a present obligation distinguishes a liability from a business risk. (March 2007, July 2007) - both business risks and liabilities cause a potential outflow of economic benefits. Hence the possibility of such an outflow does <i>not</i> distinguish a liability from a business risk. (July 2007) 	<p>Emphasis added in response to concerns from commentators (reported in May 2006) that ‘stand-ready’ obligations appeared to include a limitless number of items, including those currently regarded as business risks.</p>
<p>2.5</p> <p>‘Stand-ready’ obligations</p>	<p>A stand-ready obligation is one in which there is uncertainty about the outflow of economic benefits, <i>not</i> uncertainty about whether a present obligation exists. (July 2007)</p> <p>Uncertainty about <i>past</i> events can make it uncertain whether a liability exists. In contrast, a stand-ready obligation arises if there is uncertainty about <i>future</i> events. The hamburger and hospital examples were examples in which it was uncertain whether a present obligation existed. (May 2007)</p> <p>The label ‘stand-ready obligation’ might be confusing for some people but is a helpful short-hand term. The staff should consider other phrases or terms when drafting the standard. (March 2007)</p>	<p>Additional clarification to help explain why ‘stand-ready’ obligations do not include business risks.</p>

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<p>2.6</p> <p>Uncertainty about existence of present obligation</p>	<p>The revised IAS 37 should provide more guidance on situations (eg litigation) in which it is uncertain whether a present obligation exists. (May 2006)</p> <p>The guidance should acknowledge that it might be uncertain whether an entity has a present obligation if it is uncertain:</p> <ul style="list-style-type: none"> (a) whether a transaction or event has occurred; (b) whether a transaction or event that has occurred gives rise to a present obligation; or (c) how the law or regulations apply to that event. (July 2007) <p>The revised IAS 37 should emphasise that:</p> <ul style="list-style-type: none"> (a) identifying whether a liability exists requires judgement. (b) management should use all available evidence, which might include the entity’s own experience with similar items, other entities’ experience with similar items, opinions of experts and additional evidence provided by events that occurred after the balance sheet date. (c) the sources of evidence listed in (b) are not exhaustive. <p>The final standard should include further application guidance or be accompanied by illustrative examples. (June 2006, July 2007)</p> <p>The revised IAS 37 should not specify an explicit probability threshold for identifying liabilities in situations of uncertainty. (October 2007)</p>	<p>The proposed guidance is similar to existing guidance (in paragraph 16 of IAS 37), some of which was omitted from the exposure draft.</p> <p>Commentators asked for more guidance than that included in the exposure draft.</p> <p>The guidance is important. It clarifies that, even although the probability recognition criterion is being deleted from the revised standard (see Decision 3.1), entities defending legal claims do not necessarily recognise liabilities. Management needs to reach a judgement about whether a liability exists</p> <p>No change.</p>

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<p>2.7</p> <p>Constructive obligations</p>	<p>The final standard should not limit the recognition of constructive obligations to those that would be enforced by a court. However, the standard should emphasise the need for a present obligation (ie a duty or responsibility to another party). A management decision or an intention to incur a future outflow of economic benefits does not in itself amount to a constructive obligation. (July 2007)</p> <p>The standard should not define legal and constructive obligations as separate types of obligation—some constructive obligations can be legally enforceable. The existing definitions should be deleted and replaced by guidance within the text of the standard. (July 2007)</p>	<p>Changed wording, consistent with proposed changes to guidance on the meaning of ‘present obligation’ (see Decision 2.3)</p> <p>Eliminates an apparent contradiction in the exposure draft.</p>
<p>2.8</p> <p>Illustrative Example 1</p> <p>Disputed lawsuit</p>	<p>The conclusion proposed in the exposure draft—ie that the start of legal proceedings obliges the entity to stand-ready to perform as the court directs—was wrong. Rather, the start of legal proceedings is just one piece of evidence that would be relevant to the assessment of whether the entity has an obligation. The illustrative example should be modified accordingly. (June 2006)</p>	<p>Change in conclusion – new conclusion in line with current practice, constituent views and other decisions reported in this section.</p>

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3 Liability recognition criteria

Topic	Tentative decision	Comparison with exposure draft proposals
<p>3.1</p> <p>Probability recognition criterion</p> <p>(which requires entities to recognise liabilities only if it is probable that an outflow of resources will be required to settle the obligation).</p>	<p>The criterion should be deleted from IAS 37 (February 2008):</p> <ul style="list-style-type: none"> - it gives a flawed result, ie that some obligations (eg guarantees) are not recognised when the liability arises. - it has little impact in practice—in most cases in which a liability is identified, it is probable that there will be some outflow. - it is inconsistent with the proposed measurement requirements, which require entities to take into account all possible outcomes. - it delays the inclusion of decision-useful information in the financial statements. (June 2006) <p>The practical benefits of the criterion (ie that it stops entities having to identify and recognise liabilities for which the costs of recognition exceed the benefits) do not justify its retention. (February 2008)</p>	<p>No change.</p>
<p>3.2</p> <p>Reliable measurement criterion</p>	<p>The revised standard should continue to refer to the circumstances in which a liability cannot be measured reliably as ‘extremely rare’. There is no need for additional guidance to help preparers identify these circumstances. (June 2009)</p>	<p>No change.</p>

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<p>3.3 Recognition exemptions</p>	<p>There should be no exemptions from the recognition requirements on the grounds of disclosure of prejudicial information. The Board cannot accommodate concerns about the operation of different legal jurisdictions in one standard. Exemptions would compromise the usefulness of the information provided in the financial statements. The ‘prejudicial information’ disclosure exemption will remain in IAS 37, and is sufficient. (July 2006) The proposed changes to IAS 37 don’t introduce any new factors that will cause additional problems in the US legal environment. (June 2009)</p>	<p>No change.</p>

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4 Liability measurement

Topic	Tentative decision	Comparison with exposure draft proposals
<p>4.1</p> <p>Clarifying the measurement requirement</p>	<p>The revised standard should clarify the meaning of the proposed measurement requirement. (September 2006, December 2007)</p> <p>The revised standard should state that:</p> <p>(a) The requirement is to measure the amount that the entity would rationally pay on the reporting date to be relieved of the present obligation. (July 2009)</p> <p>(b) The amount that the entity would rationally pay to be relieved of the present obligation is the lowest of:</p> <ul style="list-style-type: none"> - the present value of the resources required to fulfil the obligation¹; - the amount the entity would have to pay to cancel the obligation; and - the amount the entity would have to pay to transfer the obligation to that party. (July 2009) <p>(c) If there is no evidence that the entity could cancel the obligation or transfer it to a third party for a lower amount, the entity measures the liability at the present value of the resources required to fulfil the obligation. (July 2009)</p> <p>Continues on next page /</p>	<p>The decision to clarify the measurement requirement responds to comments that the requirement proposed in the exposure draft was unclear.</p> <p>The additional guidance does not change the requirement proposed in the exposure draft.</p> <p>But it is based on one possible interpretation of the requirement. It is a different interpretation from that widely applied in practice at present. The Board did not discuss this (or other) interpretations in the exposure draft.</p>

¹ The wording used in July 2009 was different. The Board later refined the wording to that shown above.

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/ Continued	<p>(d) An entity estimates the present value of the resources required to fulfil the obligation using expected present value techniques. The calculations take into account:</p> <ul style="list-style-type: none"> - the outflows of resources expected to be required to fulfil the obligation (the probability-weighted average of the possible outcomes); - the time value of money; and - if the amount or timing of the outflows is uncertain, any additional amount the entity would rationally pay to be relieved of the risk that the actual cash flows will be different from those expected. (September 2009) <p>(e) An entity should measure the resource outflows at their value, not cost. If the obligation is to provide a service at a future date, the entity measures the service outflows at the amount it would rationally pay a contractor at the future date to carry out the service on its behalf.</p> <ul style="list-style-type: none"> - if a market exists for such services, the amount is the price that a contractor would charge. - if no market exists, the entity would estimate the amount. (September 2009) <p>The Board directed the staff to develop guidance explaining how, in the absence of a market, an entity would use a ‘building block’ approach to estimate the amount it would rationally pay a contractor to carry out the service. (September 2009) [Staff note: The entity would estimate how much it would charge another party to undertake the service. This amount would take into account the expected costs and the margin the entity would require for providing the service.]</p>	

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4.2 Rationale for measurement requirement	The Basis for Conclusions should explain more fully how the proposed measurement requirement derives from the existing one. (December 2007) The Basis for Conclusions should also explain more fully why the Board thinks the requirement provides relevant and reliable information. (September 2006, December 2007)	No change to requirements. Basis for Conclusions will contain more detail.
4.3 Application guidance	The revised standard should give more guidance on applying the proposed requirements (ie expected present value techniques). This should be based on existing well-established guidance in other standards, such as IAS 36 <i>Impairment</i> . This guidance—and other application guidance in the exposure draft—should be moved to an appendix, not included in the body of the standard. (Sept 2006)	Additional guidance, to reassure constituents that calculations will not necessarily be as complex as they fear. No new concepts introduced.
4.4 Risk adjustments	The standard should not give more guidance about the risks that entities should take into account when applying a risk adjustment to the expected cash flows. (February 2008) However, it should be clear that a risk adjustment would be required only if, and to the extent that, uncertainty about the expected outflows affects the amount that an entity would rationally pay to be relieved of an obligation. (April 2009)	No change. Although this point was not explicit in the exposure draft guidance, it was implicit in the wording.

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<p>4.5 Onerous sales contracts</p>	<p>There should be a limited exception to the proposed measurement requirements for onerous contracts arising from transactions within the scope of IAS 18 <i>Revenue</i> and IFRS 4 <i>Insurance Contracts</i>. Entities should measure such onerous contract liabilities by reference to the expected costs of supplying the goods or services, rather than the amounts the entity would pay a contractor to supply them on its behalf.</p> <p>The purpose of the exception would be to postpone any change in practice for measuring those contracts, pending completion of the Board's revenue and insurance projects.</p> <p>(November 2009)</p>	<p>New exemption.</p>

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5 Reimbursement rights

Topic	Tentative decision	Comparison with exposure draft proposals
5.1 Measurement objective	The revised standard should not prescribe a measurement objective for reimbursement rights. (June 2009)	No change.
5.2 Measurement guidance	The revised standard should state explicitly that the assumptions used to measure a reimbursement right should be consistent with those used to measure the related liability. (June 2009)	This was not explicit in exposure draft proposals, but is the logical way of applying them.
5.3 Asset cap	An ‘asset cap’ in the existing IAS 37 limits the amount recognised for a reimbursement right to the amount to the amount recognised for the related liability. The revised standard should omit the asset cap. (June 2009)	New proposal. Not discussed in exposure draft. NB The change would affect only the <i>measurement</i> of reimbursement rights relating to recognised liabilities. It would not extend the range of reimbursement rights that entities can recognise. The change might have little or no effect in practice if reimbursements rarely exceed actual losses.

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6 Disclosure

Topic	Tentative decision	Comparison with exposure draft proposals
<p>6.1</p> <p>Possible obligations</p>	<p>The revised standard should retain the existing IAS 37 requirement to disclose information about possible obligations, ie situations of uncertainty (typically arising from legal, arbitration or governmental proceedings in progress or pending against the entity) in which management has judged that the entity does not have a present obligation. (December 2008)</p> <p>An entity should disclose, unless the possibility of any outflow of economic benefits is remote:</p> <ul style="list-style-type: none"> - a description of the circumstances; - an indication of the financial effects; - an indication of the uncertainties relating to the amounts or timing of any outflow of economic benefits; and - the possibility of reimbursement. (June 2009) <p>The revised standard should help preparers identify when disclosure is required, by giving examples and cross-referring between the disclosure requirement and guidance on uncertainty about the existence of obligations. (June 2009)</p>	<p>New proposal—but consistent with other conclusions and existing requirements.</p> <p>The Board omitted this existing disclosure requirement from the exposure draft. It did so because, applying the exposure draft proposals, the requirement would become redundant in practice. It would be redundant because an entity involved in a legal dispute would always have to recognise a liability (ie to act as the court directs). Because the Board has reversed this conclusion (see Decision 2.8), it also needs to reinstate the disclosure requirement for possible obligations, to avoid loss of disclosure about legal disputes.</p> <p>The information that the Board proposes to require entities to disclose is essentially the same as the information they have to disclose for contingent liabilities at present.</p>

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<p>6.2</p> <p>Restructuring activities</p>	<p>The revised standard should require entities to disclose details of restructuring activities. (April 2008)</p> <p>Entities should disclose:</p> <ul style="list-style-type: none"> - a description of the restructuring activity, including the facts and circumstances leading to the expected activity and the expected completion date; - for each reportable segment, the total amount of costs expected to be incurred in connection with the activity, the amount incurred in the period, and the cumulative amount incurred to date; and - the expected timing of any outflow of economic benefits. <p>Entities should disclose this information in the period in which they first implement a restructuring plan or announce its main features to those affected. They should continue disclosing the information until the restructuring is completed. (April 2009)</p>	<p>Not in exposure draft.</p> <p>However, the proposed disclosure requirement does no more than ensure that entities will continue to disclose the same information about restructuring activities as they disclose at present.</p> <p>The decision addresses commentator concerns that the proposed change in recognition requirements for restructuring costs (see Decision 7.1) will lead to loss of disclosure.</p>

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7 Application guidance

Topic	Tentative decision	Comparison with exposure draft proposals
<p>7.1 Restructuring activities</p>	<p>Having announced a restructuring plan, management of an entity might have little or no discretion, from a commercial viewpoint, to avoid completing the plan. However, this commercial pressure does not amount to an obligation--ie a duty or responsibility to another party to complete the plan.</p> <p>(April 2008)</p>	<p>No change.</p> <p>(The decision to describe an obligation as a ‘duty or responsibility to another party’ – see Decision 2.3 – will better explain the proposal.)</p>
<p>7.2 Onerous contracts</p>	<p>Entities should measure liabilities for onerous leases net of sublease rentals that the entity could reasonably obtain, irrespective of the entity’s intentions.</p> <p>Minor drafting changes are needed:</p> <ul style="list-style-type: none"> - to avoid implying that a decline in the market price of products or services necessarily makes a contract for their purchase onerous; and - to clarify what the Board means by ‘actions’ in the requirements for contracts that become onerous because of the entity’s own actions. <p>(April 2008)</p>	<p>No change.</p> <p>Minor wording improvements will make application easier.</p>

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8 Consequential amendments to IFRS 3 *Business Combinations*

Topic	Tentative decisions (all September 2009)	Reason for amendment
<p>8.1 General</p>	<p>Requirements for ‘contingent liabilities’ in IFRS 3 need to be replaced with requirements that refer to items within the scope of the revised IAS 37. This is because:</p> <ul style="list-style-type: none"> - the term ‘contingent liability’ will be deleted from the revised IAS 37. So any references will have to be to another population of items within the scope of that standard. - when the ‘probability recognition criterion’ is deleted from IAS 37, there will no longer be different recognition criteria in the two standards. Some exceptions in IAS 37 will no longer be necessary. 	<p>Explained below for each separate decision.</p>
<p>8.2 Recognition of ‘contingent liabilities’</p>	<p>Replace the existing requirement (to recognise contingent liabilities if they are present obligations that can be measured reliably) in paragraphs 22 and 23 of IFRS 3 with a requirement to recognise liabilities within the scope of the revised IAS 37 if their fair values can be measured reliably.</p> <p>State that, except in extremely rare cases, an entity will be able to determine a reliable measure of the fair value of such liabilities.</p>	<p>Amendment preserves existing IFRS 3 requirement while making IFRS 3 terminology consistent with revised IAS 37 terminology.</p> <p>Reference reminds readers of relevant guidance already in IAS 37.</p>

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Topic	Tentative decisions (all September 2009)	Reason for amendment
<p>8.3</p> <p>Subsequent measurement</p>	<p>The special requirements for subsequent measurement of contingent liabilities should be deleted. Without these special requirements, entities will subsequently measure all liabilities within the scope of IAS 37 and assumed in a business combination in accordance with the measurement requirements of the revised IAS 37.</p>	<p>The special requirements will no longer have a significant practical impact when the recognition requirements of the two standards are aligned.</p>
<p>8.4</p> <p>Disclosures about acquisitions in period.</p>	<p>IFRS 3 should retain its requirement to disclose details of the nature of and uncertainties surrounding contingent liabilities assumed as part of business combinations in the period. (IFRS 3, paragraph B64(j))</p> <p>The requirement should apply to all assumed liabilities and possible obligations within the scope of IAS 37. It should continue to cross-refer to the disclosure requirements in the revised IAS 37.</p>	<p>‘Contingent liability’ is no longer a defined term. The amendment will expand the population of items for which disclosure is required. But the information required is the same as that required at the end of the reporting period for all liabilities and possible obligations within the scope of IAS 37. So entities will not have to disclose additional information– they will just have to give the information separately for liabilities assumed in business combinations in the period.</p>
<p>8.5</p> <p>Disclosures of adjustments from previous acquisitions</p>	<p>Delete paragraph B67(c) of IFRS 3, which requires entities to disclose additional information about adjustments to contingent liabilities that have been recognised applying IFRS 3 but would not have been recognised applying IAS 37.</p>	<p>The disclosure requirement will not be required when the recognition requirements of the two standards are aligned.</p>

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9 Consequential amendments to IFRIC 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Funds*

Topic	Tentative decisions (all September 2009)	Reason for amendment
<p>9.1</p> <p>Rights to reimbursement from funds</p>	<p>IFRIC 5 at present requires a contributor² to measure rights to reimbursement at the lower of:</p> <ul style="list-style-type: none"> - the amount of the decommissioning obligation recognised; and - the contributor’s share of the fair value of the net assets of the fund attributable to contributors. <p>This requirement should be deleted and replaced with a requirement for contributors to recognised and measure rights to reimbursement for recognised liabilities in accordance with the revised IAS 37.</p> <p>(September 2009)</p>	<p>The existing requirement aims to interpret the existing requirements for reimbursement rights in IAS 37. It needs to change if the ‘asset cap’ is deleted from IAS 37 (see Decision 5.3).</p> <p>The proposed new requirement is one of three options considered by the Board.</p>
<p>9.2</p> <p>Obligations to make additional contributions</p>	<p>The requirements in IFRIC 5 should be amended to:</p> <ul style="list-style-type: none"> - allow for the possibility that some obligations are financial liabilities within the scope of IAS 32 and IAS 39 rather than IAS 37; and - delete the ‘probability recognition criterion’. 	<p>Changes necessary to reflect in IFRIC 5 past revisions to the scope of IAS 39 and the proposed deletion of the probability recognition criterion from IAS 37 (see Decision 3.1).</p>

² Specifically a contributor that does not have control, joint control or significant influence over a fund to which it contributes.

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