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These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: **March 2006, London**

Project: **IAS 37 Redeliberations: Scope of IAS 37 (Agenda Paper 5A)**

INTRODUCTION

1. The purpose of this paper is to consider the responses received regarding the scope of IAS 37 proposed in the ED, paragraphs 2 to 9. The Board agreed to address the scope of IAS 37 at the beginning of the redeliberation process to confirm which liabilities are to be considered throughout the redeliberation process.
2. The ED proposes to clarify the scope of IAS 37 based on the following principle:

An entity shall apply IAS 37 to all liabilities that are not financial liabilities (as defined in IAS 32) except for those resulting from executory contracts (unless the contract is onerous) and those within the scope of another Standard.
3. IAS 37 currently applies to provisions, which are liabilities of uncertain timing or amount. However, if an entity has a liability that is not within the scope of another Standard, the entity is likely to look to IAS 37 for guidance (following the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*). The ED therefore clarifies the scope of IAS 37 and confirms that IAS 37 applies to all liabilities not within the scope of another Standard.

4. To emphasise this point, the ED does not use the term ‘provision’ as a defined term. Instead the ED proposes using the term ‘non-financial liability’. The ED defines a non-financial liability as ‘a liability other than a financial liability as defined in IAS 32 *Financial Instruments: Presentation*’. The Basis for Conclusions explains that this change in terminology is a logical consequence of clarifying the scope of the Standard.
5. This paper is divided into two sections reflecting the proposed amendments:
 - 1 Clarifying the scope of IAS 37
 - 2 Not using provision as a defined term and using the term non-financial liability

SUMMARY OF RECOMMENDATIONS

6. The staff recommends that:
 - (a) The Board confirm that IAS 37 applies to all liabilities not within the scope of another Standard [*paragraphs 11 - 14*].
 - (b) The wording in paragraph 7 of the ED be improved specifically to clarify that liabilities arising from the non-recognition of revenue are outside the scope of IAS 37 [*paragraph 15(a)*].
 - (c) The Basis for Conclusions be expanded to explain the analysis undertaken which leads the Board to believe that the requirements of IAS 37 are appropriate for all liabilities [*paragraph 15(b)*].
 - (d) The term ‘provision’ not be a defined term in IAS 37 [*paragraphs 23 - 25*].
 - (e) The term ‘non-financial liability’ be used to describe liabilities within the scope of IAS 37 [*paragraphs 26 - 31*].
 - (f) The scope section include positive examples of liabilities within the scope of the Standard [*paragraph 29(a)*].

- (g) The Basis for Conclusions be expanded to explain why the term ‘non-financial liability’ is used and to emphasise the specific definition of ‘non-financial’ liability in the context of IAS 37 [*paragraph 32*].

SECTION 1: CLARIFYING THE SCOPE OF IAS 37

Analysis of the comment letters

7. Many constituents view the proposal to clarify the scope of IAS 37 to include all liabilities not within the scope of another Standard as an extension of scope that establishes a default or ‘catch all’ liability Standard. A few respondents think that this is inappropriate because they believe that liabilities for which the amount or timing is not uncertain (ie which would not satisfy the current definition of a provision) should be outside the scope of IAS 37. They find the existing differentiation between certain liabilities and uncertain liabilities useful.
8. Other respondents do not believe it is appropriate to clarify that the scope of IAS 37 includes all liabilities not within the scope of another Standard *at this time*. This is because other inter-related projects (eg insurance and revenue recognition) are not sufficiently well progressed to ensure consistent guidance on accounting for liabilities across all Standards. Moreover, some respondents note that it is not yet clear that similar changes will be made to US accounting guidance. Therefore clarifying the scope of IAS 37 is likely to increase differences with US GAAP (an outcome which is contrary to the short term convergence project).
9. Even those respondents who do agree with clarifying the scope of IAS 37 are concerned that there may be liabilities not within the scope of another Standard for which the measurement and recognition requirement of IAS 37 would be inappropriate. Many are unclear on which liabilities previously outside the scope of IAS 37 will now be captured and request further guidance from the Board. For example, one respondent recommends “a full inventory of the types of liability that would be subject to the guidance should be developed and evaluated to ensure the guidance is appropriate”. Some would also like the outcome of this analysis to be documented in the final Standard or accompanying literature.
10. [*Paragraph deleted*].

Staff discussion

Liabilities for which the amount or timing is not uncertain (ie which would not satisfy the current definition of a provision) should not be within the scope of IAS 37

11. [Paragraph deleted]

12. [Paragraph deleted]

It is inappropriate to clarify the scope of IAS 37 at this time because other inter-related projects are not sufficiently well progressed

13. [Paragraph deleted]

Is the scope of IAS 37 appropriate for all liabilities that are not within the scope of other Standards?

14. [Paragraph deleted]

15. [Paragraph deleted]

Staff recommendations

16. Based on the above analysis, the staff recommends that:

- (a) The Board confirm that IAS 37 applies to all liabilities not within the scope of another Standard is appropriate.
- (b) The wording in paragraph 7 of the scope section of the ED be improved specifically to clarify that liabilities arising from the non-recognition of revenue are outside the scope of IAS 37.
- (c) The Basis for Conclusions be expanded to explain the analysis undertaken which leads Board to believe that the requirements of IAS 37 are appropriate for all liabilities.

17. ***Does the Board agree?***

SECTION 2: NOT USING ‘PROVISION’ AS A DEFINED TERM AND USING THE TERM ‘NON-FINANCIAL LIABILITY’

Analysis of the comment letters

18. Responses to this proposal are mixed. Approximately one-third of respondents (especially those based in Europe) oppose not using the term provision in the ED. These respondents believe that the term provision is widely used and understood by all stakeholders. Also they believe that the term is useful in distinguishing between certain and uncertain liabilities.
19. Other respondents note that the notion of a provision (as defined in the current IAS 37) remains implicit in the disclosure requirements of the ED because the disclosure requirements distinguish between liabilities with estimation uncertainty and those without. These respondents are concerned that omitting a definition of a provision will result in inconsistent application and reduce comparability of financial statements.
20. Other respondents agree with not using provision as a defined term but dislike the new term non-financial liability. Many find the term confusing because all liabilities can be described as financial (in a broad sense). In particular, respondents note that understanding the term non-financial liability requires reference to IAS 32. The IAS 32 definition of a financial liability includes ‘a contractual obligation to deliver cash or another financial asset to another entity’. Therefore some respondents think the term non-financial liability may be read to imply IAS 37 only applies to non-contractual liabilities or liabilities that will not be settled in cash. Many respondents recommend establishing a positive definition for IAS 37, independent of IAS 32 and its terminology. Others request that the Board consider alternative terms for both the title and the text of the Standard.
21. *[Paragraph deleted]*

Staff discussion

22. The staff notes that the discussion and conclusions drawn in this section of the paper are dependent on the conclusions drawn in section 1. If the Board does not agree with

the staff's recommendation to clarify that IAS 37 applies to all liabilities not within the scope of another Standard, the staff acknowledges that its recommendations relating to terminology may need to be revisited.

Not using provision as a defined term

23. *[Paragraph deleted]*

24. *[Paragraph deleted]*

25. *[Paragraph deleted]*

The term non-financial liability is confusing and mis-leading

26. *[Paragraph deleted]*

27. *[Paragraph deleted]*

28. *[Paragraph deleted]*

29. *[Paragraph deleted]*

30. *[Paragraph deleted]*

31. *[Paragraph deleted]*

32. *[Paragraph deleted]*

Staff recommendations

33. Based on the above analysis, the staff recommends that:

- (a) The term 'provision' not be a defined term in IAS 37.
- (b) The term 'non-financial liability' be used to describe liabilities within the scope of IAS 37.
- (c) The scope section include positive examples of liabilities within the scope of the Standard.

- (d) The Basis for Conclusions be expanded to explain why the term ‘non-financial liability’ is used and to emphasise the specific definition of ‘non-financial’ liability in the context of IAS 37.

34. ***Does the Board agree?***

Appendix A – Quantitative analysis of respondents to question in the Invitation to Comment

[Appendix deleted]

Appendix B – Liabilities identified by respondents for which the requirements of the ED may be inappropriate

[Appendix deleted]