



**International  
Accounting Standards  
Board**

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*This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.*

*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: Considering additional topics in the project scope (Agenda Paper 5B)**

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## **INTRODUCTION**

1. The purpose of this paper is to consider respondents' recommendations to include additional topics in the current IAS 37 project. At the February 2006 meeting, the Board agreed to address these topics early in the redeliberation process to confirm that the staff does not need to extend its analysis into additional areas, or to highlight the need to revise the provisional project timetable to accommodate any additional topics<sup>1</sup>.
2. This paper is divided into the following sections:
  - 1 Summary of recommendations [*paragraph 3*]
  - 2 General comments [*paragraph 4*]
  - 3 Additional topics to consider including in the current project

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<sup>1</sup> According to the project timetable, discussion about the final form of the proposed amendments to IAS 37 (either a revised IAS or a new IFRS) will be addressed in a separate Board paper towards the end of the redeliberations phase of this project therefore is not addressed in this paper.

- Recognition and measurement guidance in IAS 38 *Intangible Assets* [paragraphs 5 - 9]
- Measurement guidance for reimbursement rights [paragraphs 10-18]
- Onerous contracts [paragraphs 19-23]
- Application guidance for specific staff benefit plans [paragraphs 24 - 27]
- Measurement guidance for non-financial liabilities [paragraphs 28 - 29]

## **SECTION 1: SUMMARY OF RECOMMENDATIONS**

3. The staff does not recommend including any additional topics suggested by respondents in the current IAS 37 project, except for measurement guidance for reimbursement rights.

## **SECTION 2: GENERAL COMMENTS**

4. The staff acknowledges that all of the additional topics identified by respondents are valid topics for discussion. The staff also notes that the amendments to IAS 37 currently proposed in the ED are more extensive than originally envisaged at the start of the project. It is therefore unlikely that this Standard will be revisited again in the medium term. As a result, the current project provides an opportunity to address known issues. However, the staff believes that any decision to include additional topics in the context of this project must also consider the following:

- (a) This is not a general improvements project. Any additional topics for consideration should be consistent with the overall project objectives. These were affirmed at the February 2006 meeting as being (a) to analyse some items currently described as contingent assets and contingent liabilities in terms of assets and liabilities, and (b) to converge the application guidance for accounting for costs associated with restructurings in IAS 37 with the requirements of SFAS 146 *Accounting for Costs Associated with Exit or Disposal Activities*.
- (b) Including additional topics in the current project is likely to delay redeliberations and may require re-exposure in some circumstances. IAS 37 is

a precedential project therefore it is also necessary to consider the effect of any potential delay on other related projects. (In making this observation the staff is not implying that additional topics should be rejected on this basis, merely that the full effect of any delay should be considered in reaching a decision.)

- (c) The Board considered and rejected including additional topics in this project (including most of the topics raised by respondents covered in this paper) before issuing the ED<sup>2</sup>.

### **SECTION 3: ADDITIONAL TOPICS TO CONSIDER INCLUDING IN THE CURRENT PROJECT**

#### **RECOGNITION AND MEASUREMENT GUIDANCE IN IAS 38**

- 5. The ED proposes that items previously described as contingent assets that satisfy the definition of an asset should be within the scope of IAS 38 rather than IAS 37 (except for reimbursement rights). This is because such items are non-monetary items without physical substance and, subject to meeting the identifiability criterion in IAS 38, are intangible assets.
- 6. However, the ED does not propose amending the recognition and measurement requirements in IAS 38. In the ED, the Board acknowledged the high recognition threshold in IAS 38 for internally generated intangible assets (paragraph BC18). However, the Board explained that amending the recognition and measurement requirements IAS 38 is outside the scope of this project.

#### **Comment letter analysis**

- 7. Several respondents question the appropriateness of including items previously described as contingent assets within the scope of IAS 38. This is an issue identified for discussion later in the redeliberation process, therefore it is not analysed in this paper. However, eleven respondents recommend amending the recognition and measurement guidance in IAS 38 as part of the current project if items previously described as contingent assets are included within the scope of IAS 38.

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<sup>2</sup> Refer to the November 2004 Board Paper for detailed information.

8. Respondents recommend amending the recognition and measurement guidance in IAS 38 because:

- The current proposals create asymmetry in accounting for items previously described as contingent assets and items previously described as contingent liabilities. This is because the ED proposes omitting the probability recognition criterion from IAS 37, but no similar amendment is proposed for IAS 38. This asymmetry may result in an understatement of net assets.
- The ED is unclear whether an unconditional right is recognised independently of the probability that an uncertain future event will occur (or fail to occur). This ambiguity may create inconsistency in recognising assets previously described as contingent assets.
- Current IAS 38 guidance on subsequent measurement (eg amortisation and residual value) may not be appropriate for items previously described as contingent assets.

#### **Staff discussion**

9. The staff does not propose amending the recognition and measurement guidance in IAS 38 as part of this project [*paragraphs 9(a) –9 (c) deleted*].

#### **MEASUREMENT GUIDANCE FOR REIMBURSEMENT RIGHTS**

10. The ED proposes that when an entity has a right to reimbursement for some or all of the economic benefits that will be required to settle a non-financial liability it recognises the reimbursement right as an asset if the reimbursement right can be measured reliably. As a result, the ‘virtual certainty’ recognition criterion in the current IAS 37 is omitted. This change is consistent with the new analysis of contingent assets included in the ED.
11. The current IAS 37 does not provide measurement guidance for reimbursement rights. Therefore the Board previously argued that it is not necessary to consider this topic as part of the current project. Consequently the ED does not propose any measurement guidance for reimbursement rights.

## **Comment letter analysis**

12. Most respondents agree or make no comment on the proposed amendments to reimbursement rights in general. Some respondents think that including reimbursement rights in a liabilities Standard is illogical - this issue will be discussed later in the Board's redeliberation process. However, assuming that reimbursement rights will remain in IAS 37, eight respondents request that the Board consider including measurement guidance for reimbursement rights in any revised IAS 37.
13. These respondents have identified two potential measurement bases for reimbursements – fair value or discounted cash flows (based on the measurement guidance for the related non-financial liability in IAS 37). Respondents are concerned that the absence of guidance in the ED will result in inconsistent measurement (and asymmetry in the measurement of closely related assets and liabilities if measurement based on discounted cash flows is not used).

## **Staff discussion**

14. The staff believes that amending the recognition guidance for reimbursement rights raises new questions about measurement of those rights that merit further consideration in this project.
15. *[Paragraph deleted]*
16. *[Paragraph deleted]*
17. *[Paragraph deleted]*
18. On balance, (and assuming that guidance on reimbursement rights will remain in IAS 37), the staff believes that the Board should provide measurement guidance for reimbursement rights in IAS 37. The staff proposes presenting its analysis to the Board towards the end of the redeliberation phase in 2007. This timing will allow the staff to consider the outcome of earlier Board discussions on contingent assets and measurement before the Board discussion of measurement guidance for reimbursement rights. The effect of this recommendation on the overall project timetable is considered in appendix A.

## ONEROUS CONTRACTS

19. The ED proposes that if a contract becomes onerous as a result of an entity's own action, the liability should not be recognised until the entity takes that action. Additionally, the ED proposes that, if the onerous contract is an operating lease, the unavoidable cost of the contract should be reduced by the estimated sublease rentals that the entity could reasonably obtain, regardless of whether the entity intends to enter into a sublease.
20. The purpose of these amendments is to *add* to the existing IAS 37 requirements in order to reduce differences in the accounting for contract termination costs under IAS 37 and SFAS 146. The ED does not reconsider the accounting for onerous contracts more generally and, for example, does not propose amending the current definition of an onerous contract in IAS 37.

### Comment letter analysis

21. Most respondents agree or make no comment on the ED's proposal that a liability for an onerous contract should not be recognised until the entity takes that action. However, thirteen respondents request clarification on the existing definition of an onerous contract and/or the accounting for onerous contracts more generally. These respondents note that the current definition and guidance causes confusion which results in inconsistent treatment. Therefore the current project is an opportunity to improve the guidance available. Specific ambiguities in the current Standard (and carried forward to the ED) identified in the comment letters include:
- Lack of guidance on recognising a liability in respect of a contract when 'the unavoidable costs of meeting the obligations exceed the expected economic benefits' arise due to circumstances outside an entity's control. For example, leasing a property at above market rates following a change in market conditions.
  - Inconsistency in the current measurement guidance. Paragraph 66 of the current Standard requires an entity to recognise 'the present obligation under the contract', indicating that the liability is the *gross* present obligation. However, paragraph 68 states that 'the unavoidable costs under a contract

reflect the least net cost of exiting from the contract', indicating a *net* present obligation.

- Not all obligations are binary in nature. A contract may only be onerous under certain conditions therefore some respondents recommend that the accounting guidance should also require the probability of a change in condition to be recognised and reflected.

22. [Paragraph deleted]

### **Staff discussion**

23. The staff does not believe considering the general accounting for onerous contracts or the current definition of an onerous contract in the context of this project is appropriate. [Paragraphs 23(a) – 23(d) deleted].

### **APPLICATION GUIDANCE FOR SPECIFIC STAFF BENEFIT PLANS**

24. The ED proposes amending the definition of termination benefits in IAS 19 to clarify that *termination benefits* are employee benefits provided in connection with the termination of an employee's employment before the normal retirement date. The ED also clarifies that benefits offered in exchange for an employee's decision to accept voluntary termination of employment are only termination benefits if they are offered for a short period. Other employee benefits offered to encourage employees to leave service before the normal retirement date are *post-employment benefits*.
25. The ED therefore clarifies that benefit plans whereby employees reduce their working hours in exchange for a less than proportional decrease in salary are *not* termination benefits because the beneficial salary is not limited to a short period. The ED does not propose detailed application guidance for these specific benefit plans.

### **Comment letter analysis**

26. Three European based respondents commented on the absence of application guidance for benefit plans whereby employees reduce their working hours in exchange for a less than proportional decrease in salary. One of the three respondents does not believe application guidance is necessary. However, the other two

respondents recommend including application guidance on how to account for these benefit plans in IAS 19 to prevent inconsistency.

#### **Staff discussion**

27. The staff does not believe including this topic in the current project is appropriate *[Paragraphs 27(a) – 27(b) deleted]*.

#### **MEASUREMENT GUIDANCE FOR NON-FINANCIAL LIABILITIES**

28. The ED proposes that an entity should measure a non-financial liability at the amount that it would rationally pay to settle the present obligation or to transfer it to a third party on the balance sheet date. The ED also explains that an expected cash flow approach is an appropriate basis for measuring both a class of similar obligations and a single obligation. The Board regards these proposals as being limited to (a) clarifying the existing measurement principle, and (b) eliminating an exception to this principle in the measurement guidance. Therefore the Board has not addressed additional measurement topics in this project, including:

- Identifying one clear measurement objective in IAS 37,
- Whether discount rates should reflect an entity's own credit risk, and
- How to reflect uncertainty about timing in an expected cash flow calculation.

#### **Comment letter analysis and staff discussion**

29. Most respondents disagree with the proposed amendments to measurement in the ED and regard the changes as more significant than the Board suggests. The current project timetable proposes discussing all measurement issues in September and October 2006. The staff thinks that it is more efficient to consider the additional topics listed above as part of the complete measurement package. Therefore the staff recommends deferring any further discussion on including these topics this project until September and October 2006.



**Appendix A: Effect of the staff recommendation to include measurement guidance for reimbursement rights in the IAS 37 project on the overall project timetable**

*[Appendix deleted]*