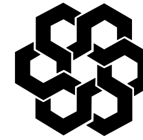

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International Accounting Standards Board

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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:	**18 October 2006, London**
Project:	**Liabilities - amendments to IAS 37**
Subject:	**IAS 37 Redeliberations: Does the proposed measurement principle permit choice? (Agenda Paper 8)**

INTRODUCTION

1. The measurement principle proposed in the IAS 37 ED is: An entity shall measure a liability at the amount that it would rationally pay to settle the present obligation or transfer it to a third party on the balance sheet date. This principle is derived from the explanation of 'best estimate' in paragraph 37 of the existing IAS 37.

2. During previous discussions the Board has noted that the proposed measurement principle is expressed using two different phrases – 'amount to settle' and 'amount to transfer'. The use of two different phrases has caused confusion. Some believe that the use of two different phrases indicates choice – that it to say, there is a difference between 'amount to settle' and 'amount to transfer'. Others disagree.

3. The purpose of this paper is to (a) analyse whether the proposed measurement principle permits choice, and (b) consider how to resolve the confusion caused by using two different phrases to express the proposed measurement principle.

4. After the staff recommendation the remainder of this paper is structured as follows:

Section A: Comment letter analysis [paragraphs 7-10]

Section B: Narrowing down the issue [paragraphs 11-15]

Section C: A reminder about the scope of this project [paragraphs 16-17]

Section D: 'Amount to settle' [paragraphs 18-40]

Section E: 'Rationally' [paragraphs 41-60]

STAFF RECOMMENDATION

5. The staff recommends removing 'amount to transfer' from the measurement principle in any final Standard.

6. The staff also recommends emphasising the following points in the text of any final Standard:

- the measurement principle is based on a current settlement notion - 'amount to settle on the balance sheet date' means the amount an entity would pay to fully extinguish a liability on that date.
- an entity may settle a liability on the balance sheet date in two ways: paying the counterparty to release the entity from its obligation, or paying a third party to assume its obligation.
- an entity should give precedence to market information when available. In the absence of market information, entity-specific information is consistent with the measurement principle.

A. COMMENT LETTER ANALYSIS

7. Many respondents limit their comments to observing that the proposed measurement principle is not clear.[1] These respondents ask the Board to confirm whether the proposed measurement principle permits choice. If

[1] For example, [one respondent] notes 'It is not clear whether the amount the entity would need to pay a third party when transferring a risk is an entity-specific or market value …'

choice is permitted, these respondents also ask the Board to explain how an entity should choose between the amount to settle and the amount to transfer a liability on the balance sheet date.[2]

8. Other respondents indicate that they believe the proposed measurement principle permits choice. These respondents argue that 'amount to settle' requires the use of entity-specific information, whereas 'amount to transfer' requires the use of market information. These respondents note that choice could result in the same liability being measured at different amounts, reducing the comparability of financial information.

9. More specifically, some respondents indicate that they would expect 'amount to transfer' to be greater than 'amount to settle' because:

   (a) a third party is likely to demand a profit margin over and above the compensation required to assume the risks and uncertainties associated with the liability itself.

   (b) information asymmetry exists. A third party is likely to demand additional compensation for assuming an 'unknown' liability.

10. No respondents explicitly state that they believe the proposed measurement principle does not permit choice. However, the staff notes that many respondents argue that the objective underlying the proposed measurement principle is fair value. Logically, this implies that these respondents do not believe that the proposed measurement principle permits choice - if there is only one underlying objective (fair value), there can be no difference between 'amount to settle' and 'amount to transfer'.

[2] For example, [one respondent] recommends 'if the Board is of the opinion that paragraph 29 refers to only one measurement basis, the IASB should use one word or phrase to describe that measurement basis. If the IASB maintains the two measurement bases, the [we] propose that the selection of a measurement base should depend on management's intention, similar to the principles contained in IAS 36 *Impairment of Assets.*'
[Another respondent] states 'we believe the IASB should clarify why it believes that this optionality is appropriate and provide guidance regarding the selection of a measurement alternative.'

B. NARROWING DOWN THE ISSUE

‘Amount to settle’

11. This paper focuses on understanding the phrase ‘amount to settle’. The staff does not believe it is necessary to further analyse the phrase ‘amount to transfer’. This is because the comment letters indicate general agreement that ‘amount to transfer’ is (i) a current settlement notion, and (ii) gives precedence to market information over entity-specific information. This agreement is also consistent with the definition of ‘transfer’ most recently discussed by the Board in the context of the fair value measurement project.[3]

12. Therefore this paper uses ‘amount to transfer’ as the reference point for determining whether the proposed measurement principle permits choice. That is to say, *if* ‘amount to settle’ is not a current settlement notion, or *if* ‘amount to settle’ does not give precedence to market information over entity-specific information, there would be a difference between ‘amount to settle’ and ‘amount to transfer’. And if this were so, the proposed measurement principle would permit choice. (The reverse logic also applies.)

’Rationally’

13. During the September 2006 Board meeting the Board briefly discussed whether the measurement principle permits choice. Discussions centred on the purpose of the word ‘rationally’ in the proposed measurement principle.

14. Some understand ‘rationally’ to mean that all parties have the same knowledge and information about a liability. But some Board members disagreed. These Board members noted that many different variables may be reflected in a market price. As a result there may be more than one market measure of a liability. They argued that the word ‘rationally’ in the paragraph 37 of IAS 37 (the proposed measurement principle) is intended to convey that when more than one measure of a liability exists, an entity should select the lowest

[3] SFAS 157 Fair Value Measurements, paragraph 5 defines fair value as ‘*the price that would* be received to sell an asset or *paid to transfer a liability* in an orderly transaction between *market* participants *at the measurement date*.’ (emphasis added)

measure on the balance sheet date. This is because an entity would *rationally* choose to settle at the lowest amount. This paper explores both views.

15. The decision tree in appendix A summarises the three questions considered in this paper and the logic underpinning both the structure of this paper and the staff's conclusion.

C. A REMINDER ABOUT THE SCOPE OF THIS PROJECT

16. In September 2006 the Board tentatively affirmed its intention to limit the scope of this project to emphasising the existing IAS 37 measurement principle and clarifying aspects of the accompanying guidance.[4] Amending the existing IAS 37 measurement principle and/or undertaking detailed research on topics not already addressed is beyond the scope of this project.

17. As a result, the analysis in this paper has been limited to examining the text of IAS 37 and other sources of information available when IAS 37 was being developed, or shortly after IAS 37 was issued in 1998. The staff is aware that some of the issues in this paper are also being discussed in the context of other projects (such as the conceptual framework and insurance). Therefore the staff emphasises that any observations or conclusions in this paper are not intended to pre-empt or set a precedent for other projects because this paper does not consider more recent thinking.

D. 'AMOUNT TO SETTLE'

18. This section considers whether 'amount to settle' (i) is a current settlement notion, and (ii) gives precedence to market information over entity-specific information.

Is 'amount to settle' a current settlement notion?

A reminder of previous Board discussions

19. At the September 2006 Board meeting the Board affirmed its understanding that the existing IAS 37 measurement principle is based on a current settlement notion. That is to say, the amount an entity would have to pay to

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[4] See agenda paper 8A presented at the September 2006 Board meeting.

fully extinguish a liability on the balance sheet date, not the amount an entity expects to pay to fully extinguish a liability in the future.[5]

No counterparty exists

20. Subsequent to last month's discussions the staff has become aware that some constituents query the applicability of the Board's conclusion when no counterparty exists. The existing IAS 37 measurement principle only includes one phrase – 'amount to settle'.[6] But neither the measurement principle nor the supporting text in IAS 37 specify with whom an entity should settle its liability.

21. Consider the following example:

Entity Z operates an offshore oil rig and its licensing agreement requires Entity Z to remove the oil rig at the end of production and restore the sea bed. Based on past experience, Entity Z estimates that it will take two years from the date it stops drilling to completely remove the oil rig and restore the sea bed. On the balance sheet date, Entity Z estimates that it would have to pay CU 14 million to settle its obligation over the next two years if it stopped drilling immediately. On the balance sheet date, the remaining useful economic life of Entity Z's oil rig is fifteen years. Entity Z expects to continue drilling for oil for the next fifteen years and estimates that it would have to pay CU 20 million to fully extinguish its obligation in years sixteen and seventeen.

22. In this example, Entity Z cannot settle (fully extinguish) its liability on the balance sheet date. Even if Entity Z stopped drilling immediately, it would take two years to remove the oil rig and restore the sea bed. Therefore, when no counterparty exists, some constituents argue that 'amount to settle' requires

[5] See agenda paper 8B presented at the September 2006 Board meeting.
[6] IAS 37, paragraph 36: 'The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the balance sheet date.' The phrase 'amount to transfer' is only used in the explanation accompanying the measurement principle (paragraph 37).

Entity Z to estimate the amount it would cost the entity to settle its liability in the future (either CU 14 million or CU 20 million in this example).

23. Estimating the amount it would cost Entity Z to settle its liability in the future is cost accumulation approach. This is inconsistent with a current settlement notion. Therefore these constituents argue that there is a difference between 'amount to settle' and 'amount to transfer' on the balance sheet date.

Staff discussion

24. The staff agrees that Entity Z could not fully extinguish its liability on the balance sheet date, even if it stopped drilling immediately. But the staff does not agree that this overrides the Board's previous conclusion that the existing IAS 37 measurement principle is based on a current settlement notion.

25. The existing IAS 37 does not specify with whom an entity should settle a liability. But the staff thinks that paragraph 37 in IAS 37 indicates that a liability may be settled (fully extinguished) on the balance sheet date in two ways: paying the counterparty to release the entity from its obligation, or transferring the obligation to a third party.

26. In this example, no counterparty exists. But Entity Z could estimate the amount it would have to pay to transfer its obligation to a third party on the balance sheet. Therefore this should be the basis for estimating Entity Z's liability on the balance sheet date.

27. The staff's understanding of 'to settle' when no counterparty exists is also consistent with Concepts Statement No. 7 *Using Cash Flow Information and Present Value in Accounting Measurements* which states: '… Some of an entity's liabilities, like an obligation for environmental cleanup, are not the assets of identifiable individuals. However, such liabilities are sometimes settled through assumption by a third party …' [7]

[7] Concepts Statement No. 7, paragraph 77. Concepts Statement No. 7 is a useful reference because, like IAS 37, Concepts Statement No. 7 uses both 'to settle' and 'to transfer'. For example, paragraph 75 states: 'when using present value techniques to estimate the fair value of a liability, the objective is to estimate the value of the assets required currently to (a) settle the liability with the holder or (b) transfer the liability to an entity of comparable credit standing.'

28. Entity Z should *not* estimate the amount settle its obligation on the balance sheet date by reference to the amount it would cost Entity Z to settle its obligation in the future. This is because neither CU 14 million nor CU 20 million reflects the amount Entity Z would have to pay to fully extinguish its obligation *on the balance sheet date*.

29. The staff believes that its emphasis on the phrase 'on the balance sheet date' is appropriate. In particular the staff notes the following:

    (a) Paragraph 37 of IAS 37 acknowledges that it will often be impossible or prohibitively expensive for an entity to settle or transfer an obligation at the balance sheet date. Nevertheless, paragraph 37 concludes that an estimate of the amount an entity would rationally pay to settle or transfer an obligation at the balance sheet date gives the best estimate of the expenditure required to settle the present obligation at the balance sheet date. This conclusion is echoed in FRS 12 *Provisions, Contingent Liabilities and Contingent Assets*, the UK equivalent of IAS 37.[8]

    (b) Paragraph 24 of the exposure draft (ED59) issued by the IASC in 1997 explains 'amount to settle' means 'what the enterprise would rationally pay to settle the obligation *immediately*'. Similar wording is used in AASB 1044 *Provisions, Contingent Liabilities and Contingent Assets,* the Australian equivalent of IAS 37. [9]

Does 'amount to settle' require an entity to give precedence to market information over entity-specific information?

30. The staff does not believe 'amount to settle' precludes the use of entity-specific information. But when market information is available, the staff

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[8] The UK Accounting Standards Board (ASB) issued FRS 12 in September 1998, shortly after IAS 37. Appendix VI of FRS 12 notes that FRS 12 was developed in conjunction with the IASB and that there are 'no differences of substance' between FRS 12 and IAS 37. Appendix VII, paragraph 22 explains that 'it will often be impossible or prohibitively expensive to settle or transfer an obligation at the balance sheet date … However, a provision should, in principle, be recognised at the amount of the obligation that existed at the balance sheet date.

[9] The Australian Accounting Standards Board (AASB) revised AASB 1044 in October 2001 to achieve consistency with IAS 37.

believes that the existing IAS 37 requires an entity to give precedence to market information over entity-specific information.

31. The staff's conclusion is based on the following sources:

(a) IAS 37 itself. For example, paragraph 47 states that an entity should select a discount rate that reflects *current market assessments* of the time value of money. IAS 37 does not permit the use of entity-specific information such as the weighted-average cost of capital. Moreover, the text of IAS 37 makes no distinction between information used to estimate 'amount to settle' and information used to estimate 'amount to transfer'. This implies that the same information is used to estimate both.

(b) measurement guidance in other standards developed at the same time IAS 37. For example, IAS 36 *Impairment of Assets* requires an entity to 'give greater weight to external evidence' and include 'other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset' when estimating an asset's value in use.[10]

(c) national equivalents of IAS 37. For example, appendix VII of FRS 12 *Provisions, Contingent Liabilities and Contingent Assets* (the UK equivalent of IAS 37) states 'for a liability where there is a market, the best estimate of that liability at the balance sheet date would be its market value.'[11]

(d) independent guidance. For example, in its published IFRS guidance [one large accounting firm] explains that 'the addition of 'rationally' in IAS 37(37) suggests that, although it may be difficult to arrange settlement or transfer, there is nevertheless a point of balance, and thus a price, at which management, taking all possible outcomes into account, could be willing to settle.'[12]

[10] IAS 36, paragraphs 33(a) and paragraph 30(e). IAS 36 was also issued in 1998 and was developed concurrently with IAS 37.
[11] FRS 12, appendix VII, paragraph 22.
[12] *iGAAP 2005: IFRS reporting in the UK*, chapter 11, paragraph 4.1.

(e) the Draft Statement of Principles (DSOP), issued by the IASC Steering Committee on Provisions and Contingencies in 1996. Paragraph 35 in the DSOP explains that '… in principle, the amount of a provision should be estimated from market value'. (However, it should be noted that the DSOP's explicit reference to market value was not carried forward to the IASC's subsequent exposure draft or standard.)

Absence of market information

32. In the absence of a market, the staff believes that using the entity's own information to estimate the 'amount to settle' a liability is compatible with a current settlement notion. The staff's observation is not new. For example, in the context of explaining the difference between fair value less costs to sell (a market-based measure) and value in use (an entity-specific measure), IAS 36 *Impairment of Assets* explains that:

> '*If no deep and liquid market exists for an asset, IASC considered that value in use would be a reasonable estimate of fair value*. This is likely to happen for many assets within the scope of IAS 36: observable market prices are unlikely to exist for goodwill, most intangible assets and many items of property, plant and equipment. Therefore, it is likely that the recoverable amount of these assets, determined in accordance with IAS 36, will be similar to the recoverable amount based on the fair value of these assets.'[13]

33. The observation is particularly pertinent in the context of this paper because no market information exists for many liabilities within the scope of IAS 37.

34. The practical implications of the staff's conclusion may be illustrated by continuing the asset retirement obligation example above. When estimating its obligation on the balance sheet date, Entity Z would consider the amount it would pay third party to remove the oil rig and restore the sea bed. Entity Z would not consider the amount it would cost to remove the oil rig and restore the sea bed using internal resources unless no market information is available.

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[13] IAS 36, paragraph BCZ118 (emphasis added).
Similarly, CON. 7, paragraph 38 notes: 'the use of an entity's own assumptions about future cash flows is compatible with an estimate of fair value, as long as there are no contrary data indicating that market place participants would use different assumptions'. This conclusion was affirmed when the FASB issued SFAS 157 *Fair Value Measurements* earlier this year (appendix C, paragraph C85).

Conclusion

35. Based on the Board's previous discussions and the analysis above, the staff concludes that 'amount to settle' (i) is a current settlement notion, and (ii) gives precedence to market information over entity-specific information when market information exists. Therefore there is no difference between the 'amount to settle' and the 'amount to transfer' and the proposed measurement principle does not permit choice.

Resolving confusion

36. The perception of choice in measuring liabilities within the scope of IAS 37 is not a new issue created by the ED. Both phrases - 'amount to settle' and 'amount to transfer' - are used in the explanation accompanying the existing IAS 37 measurement principle. However, the ED gives greater prominence to this issue because both phrases are used in the proposed measurement principle itself.

37. Despite its conclusion that there is no difference between 'amount to settle' and 'amount to transfer', the staff notes that one way to address the perception that the proposed measurement principle permits choice is to remove either 'amount to settle' or 'amount to transfer' from the measurement principle in any final Standard. The staff recommends removing 'amount to transfer'.

38. The staff acknowledges that the comment letters indicate that 'amount to transfer' is widely understood. Therefore, arguably, removing 'amount to settle' from the measurement principle is less likely to cause confusion. However, the staff recommends removing 'amount to transfer' in the IAS 37 measurement principle in deference to the limited scope of this project. Including 'amount to settle' in the measurement principle and 'amount to transfer' in the accompanying guidance is consistent with the approach used in the existing IAS 37.

39. The staff also recommends emphasising the following points in the explanation of the measurement principle in the text of any final Standard:

- the measurement principle is based on a current settlement notion - 'amount to settle on the balance sheet date' means the amount an entity would pay to fully extinguish a liability on that date.

- an entity may settle a liability on the balance sheet date in two ways: paying the counterparty to release the entity from its obligation, or paying a third party to assume its obligation.

- an entity should give precedence to market information when available. In the absence of market information, entity-specific information is consistent with the measurement principle.

40. An alternative solution is to retain both phrases in the measurement principle, but clarify that 'amount to settle' means settle with the counterparty in the principle itself. That is to say the revised measurement principle would read: An entity shall measure a liability at the amount that it would rationally pay to settle the present obligation *with the counterparty* or transfer it to a third party on the balance sheet date. However, this alternative less obviously addresses the perception that the measurement principle permits choice.

E. 'RATIONALLY'

41. This section explores two different views about the purpose of the word 'rationally' in both IAS 37 and the proposed measurement principle using the example of a product warranty. This section assumes that the Board agrees with the staff's conclusion in section D: 'amount to settle' and 'amount to transfer' are both based on a current settlement notion and give precedence to market information when available.

Understanding the different views

42. The facts and circumstances of the example are as follows:

> Entity X sold 100 products with 12 months warranty coverage each. The terms and conditions of the warranty coverage for each product are identical.
>
> On the balance sheet date Entity X estimates that the costs it expects to incur to repair or replace products which develop a fault within the remaining

warranty period total CU 8,000. On the same date, Entity X receives an outsourcing quote from Entity Y, indicating that Entity Y would be willing to assume its portfolio of product warranties for CU 10,000.

Application of the staff's conclusions in section D

43. Consistent with the conclusion in section D, Entity X may settle (fully extinguish) its obligation on the balance sheet date by transferring its portfolio of product warranties to Entity Y, or paying each warranty-holder to release Entity X from its obligation. But Entity X could *not* settle (fully extinguish) its obligation on the balance sheet date by undertaking to repair or replace any products which develop a fault within the remaining warranty period.

44. Also consistent with conclusion in section D, Entity X would give precedence to market information when available. In this example, Entity X would *not* use its own estimate of the costs it expects to incur to repair or replace products which develop a fault within the remaining warranty period (CU 8,000).

View A

45. View A understands the word 'rationally' to mean that all participants have equal knowledge about a liability - there is no information asymmetry. Therefore a third party would be unable to demand a significant profit margin over and above the compensation received for assuming the risks and uncertainties inherent in the liability.

46. Applying View A to this example: Entity Y has the same product knowledge as Entity X. Therefore Entity Y's quote includes compensation for the risks and uncertainties inherent in the portfolio of product warranties, but Entity Y is unable to demand an additional profit margin. Each individual warranty-holder has the same product knowledge as Entities X and Y. Therefore it is reasonable to assume that Entity X would have to pay a total of CU 10,000 to settle (fully extinguish) its obligation with each warranty-holder on the balance sheet date.[14]

[14] CU 100 each assuming all product warranties were sold on the same day.

47. In other words there is no difference between the amount Entity X would have to pay to 'transfer' its obligation to Entity Y and the amount it would have to pay to 'settle' its obligation with the warranty-holders. This is because:

- Entity Y would not be willing to accept less than the market price (CU 10,000) to assume Entity X's portfolio of product warranties.
- Each warranty-holder would require compensation equal to the amount he/she would have to pay to purchase the equivalent protection from an alternative source. Entity Y is an alternative source. Therefore each warranty-holder would not be willing to accept less than CU 100 to release Entity X from its obligation (CU 10,000 in total).
- Entity X would not be willing to pay each warranty-holder more than CU 100 (CU 10,000 in total). If each warranty-holder demanded more than CU 100, Entity X would transfer its portfolio of product warranties to Entity Y for CU 10,000.

48. Following this logic, the difference between Entity Y's quote (CU 10,000) and Entity X's estimate (CU 8,000) represents Entity X's greater skill and efficiency in repairing or replacing products which develop a fault within the remaining warranty period. It does not represent a difference in knowledge between Entity X and Entity Y, or additional compensation required by Entity Y to assume the portfolio of product warranties.

View B

49. View B does not assume that all participants have equal knowledge. As a result there may be more than one measure of the same liability. Applying View B to this example: Entity X is likely to have greater product knowledge than Entity Y. Therefore Entity Y's quote includes an additional amount to compensate Entity Y for assuming an 'unknown' liability.

50. Proponents of Entity B would also argue that it is not appropriate to assume that Entity X would have to pay a total of CU 10,000 to the warranty-holders to release Entity X from its obligation because it would have pay Entity Y CU

10,000 to assume its portfolio of product warranties. Factors causing a difference might include:

- information asymmetry. Entity Y may have more product knowledge and access to better technology than each individual warranty-holder.
- economies of scale.
- the law of larger numbers means that the difference between the compensation received from Entity X and the actual cash flow required to repair or replace any products which develop a fault in the remaining warranty period is lower for a portfolio than an individual product warranty.
- risk adversity. The warranty-holders are not a homogenous population. Some individual warranty-holders may be more or less risk adverse than others, and more or less risk adverse than Entity Y.
- time efficiencies. Entity X may be willing to pay Entity Y more per warranty than it would be willing to pay individual warranty-holders because the additional compensation would offset the additional time cost likely to be incurred in reaching agreement with one hundred individuals.

51. Consequently, proponents of View B would argue that Entity X is likely to be presented with a range of estimates to settle or transfer its liability on the balance sheet date. *Rationally* Entity X would select the lowest amount.

Staff discussion

52. A review of the text of IAS 37 and other sources of information favours View B - there may be more than one measure of the same liability on the balance sheet date. For example:

    (a) The papers of the IASC Steering Committee on Provisions and Contingencies indicate that, at least initially, the measurement principle supported View A. For example, an analysis of comments received in response to the DSOP notes '… The reference to market

value in the DSOP assumed that if a market existed it would be an efficient market ...' However, in the same paper, the original project staff recommended that the reference to market value be removed and more emphasis be placed on an amount that represents 'as closely as possible the amount an entity would have to pay to settle the obligation or persuade a third party to assume'.[15] This suggests a shift away from View A and towards View B.

(b) The IAS 36 Basis for Conclusions explains the IASC decided to define the recoverable amount of an asset as the higher of fair value less costs to sell and value in use because 'if an asset's net selling price is higher than its value in use, a *rational* entity would dispose of the asset'. The Basis for Conclusions goes on to explain that measurement of an asset's recoverable amount should 'reflect the likely behaviour of a rational management' and that 'no preference should be given to the market's expectation … over a reasonable estimate performed by the individual enterprise which owns the asset …' because 'perfect markets do not exist for many of the assets within the scope of IAS 36 …'[16] However, it should be noted that the staff found no cross-reference to IAS 36 when reviewing the papers of the IASC Steering Committee on Provisions and Contingencies.

(c) The explanation accompanying FRS 12 may also be read to support View B. Appendix VII notes: 'a provision should, in principle, be recognised at the amount of the obligation that existed at the balance sheet date - ie *the least cost amount* to settle the existing present obligation.'[17] 'Least cost amount' implies that other, higher estimates could exist for the same liability.

53. However, there is little objective evidence in the existing IAS 37 itself to support either View.

[15] Agenda paper 2, paragraphs 4.8 and 4.9 presented at the April 1997 meeting of the Steering Committee on Provisions and Contingencies.
[16] IAS 36, paragraphs BCZ22 and BCZ23 (emphasis added)
[17] FRS 12, appendix VII, paragraph 22.

54. From a conceptual perspective, View B is less appealing because it may result in more than one measure of the same liability, reducing comparability. Therefore one option is to invest more time researching and debating the merits of both Views and/or other views. But, as noted in section C, this option is beyond the scope of this project. Moreover, in the context IAS 37, the staff questions the practical benefits which could be derived from further research and debate.

55. In section D the staff concluded that an entity's estimate of a liability should be based on a current settlement notion and should give precedence to market information. As a result Entity Y's quote would be given precedence over Entity X's own cost estimate when estimating the amount to settle or transfer the portfolio of product warranties on the balance sheet date. Based on the facts and circumstances given in this example, Entity X has no objective information indicating that the total amount it would have to pay to individual warranty-holders to release Entity X from its obligation would be significantly more or less than CU 10,000. Therefore, in the absence of any other market information, Entity X would continue to give precedence to the CU 10,000 quote received from Entity Y.

56. Similarly, when no market information is available, section D concludes that entity-specific information is consistent with the measurement principle. When no market information is available, there may be little difference between applying View A and View B in practice.

57. For example, an entity could settle (fully extinguish) a liability arising from a lawsuit in two ways: pay the plaintiff (the counterparty) to absolve the entity of any future obligations arising from the facts and circumstances in dispute; or pay a third party to assume the risks and uncertainties associated with the final outcome of the lawsuit. In the absence of market information, an entity is likely to base its estimate on legal advice. Legal advice might indicate that the entity would have to pay the counterparty CU 1 million on the balance sheet date to absolve the entity of any future obligations arsing from the facts and circumstances in dispute.

58. View A would argue that all market participants have equal knowledge and information therefore a third party would also require CU 1 million to assume the lawsuit. View B would argue that a third party is likely to have less knowledge about the case than either the entity or the counterparty and therefore would require additional compensation. The absence of any market means it would be very difficult to objectively quantify the amount of extra compensation required. But following View B, quantification would not be necessary because *rationally*, the entity would select the lower of the two estimates - CU 1 million.

Conclusion

59. Based on the analysis above, the staff concludes that there may be more than one measure of a liability within the scope of IAS 37.

60. The staff notes that this conclusion does not preclude the Board clarifying other aspects of the IAS 37 measurement guidance. For example, emphasising that the measurement principle is based on a current settlement notion and that an entity should give precedence to available market information would reduce inconsistency and improve the comparability of financial statements.

Appendix A: Summary of the issues considered in this paper and the logic underpinning the conclusion in each section of this paper

This decision tree is based on two assumptions:

(1) 'Amount to transfer' requires the use of current, market information

(2) 'Amount to settle' means 'fully extinguish a liability'

In light of the limited scope of this project, each question starts with '*does*', not '*should*'.