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**International  
Accounting Standards  
Board**

*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:** 23 January 2007, London

**Project:** Liabilities - amendments to IAS 37

**Subject:** IAS 37 round-table discussions: planning the next stage of this project (Agenda paper 4B)

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### **INTRODUCTION**

1. Agenda paper 4A summarises the outcome of the round-table discussions. This paper considers how we might use those discussions in planning the next stage of this project.
2. The main objective of the round-table discussions was to hear participants' views on the Board's tentative conclusions reached after redeliberating issues associated with the liability recognition and measurement principles proposed in the ED. In addition to commenting on these principles, many participants questioned the Board's motivation for undertaking this project and proposing amendments to IAS 37 at this time. In particular, they argued that:

- (a) there are no pervasive issues in IAS 37 requiring immediate attention and the inconsistencies between IAS 37 and other standards do not justify the significant changes proposed; or
- (b) the proposed amendments merit debate and further development, but the Board should continue its work in the context of the conceptual framework project or other related projects.

(See paragraphs 5-12 of agenda paper 4A for further detail.)

- 3. In planning the next stage of this project, this paper also addresses these comments.
- 4. The paper divides into four sections:

- Section 1: **Project objectives** - this section revisits the Board's previous conclusions on the project objectives, reflecting on what we have learned through redeliberations in the last year and the feedback received at the round-tables (addressing the point in paragraph 2(a)).
- Section 2: **Issues requiring further research and debate** – in this section the staff presents its analysis of participants' views on the Board's tentative conclusions and identifies those issues requiring further work in the next stage of this project.
- Section 3: **Our overall approach** - having identified those issues requiring further work, this section considers our overall approach to progressing that work (addressing the point in paragraph 2(b)).
- Section 4: **Provisional project timetable** - finally, in this section the staff outlines an updated project plan.

5. At this meeting the staff will ask the Board to consider the outcome of the round-table discussions (summarised in agenda paper 4A) and the staff's analysis in this paper and then:
  - (a) confirm the project objectives;
  - (b) approve the staff's assessment of issues requiring further research and debate;
  - (c) approve the overall approach to the next stage of this project; and
  - (d) approve the provisional project timetable.

## **SECTION 1: PROJECT OBJECTIVES**

### **Re-capping previous Board discussions**

6. The objective of this project is to analyse items currently described as 'contingent liabilities' in terms of liabilities, as defined in the *Framework*. The initial prompt for this objective was the tension between the treatment of acquired contingencies in Business Combinations Phase II and IAS 37. But the proposed amendments affect all items currently described as 'contingent liabilities', not just those acquired in a business combination.<sup>1</sup>
7. The Board began its redeliberations by confirming this objective.<sup>2</sup> In particular, the Board noted that:
  - (a) retaining the notion of a 'contingent liability' is inconsistent with the overriding principle that an acquirer should recognise the assets acquired and liabilities assumed in a business combination. Some contingent liabilities are, in fact, *liabilities* and therefore are recognised in a business

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<sup>1</sup> The second project objective is to converge the IAS 37 guidance on accounting for restructuring costs with the guidance in SFAS 146 *Accounting for Costs Associated with Exit or Disposal Activities*. The Board has not started redeliberating the issues associated with this objective and this objective was not discussed at the round-tables.

<sup>2</sup> See agenda paper 8 presented at the February 2006 Board meeting.

combination. But following IAS 37, these liabilities are not recognised on day 2 if the acquirer believes that a future outflow of economic benefits to settle a liability is less than probable.

- (b) the material relating to the definition of a liability developed in this project is an important building block for other projects such as revenue recognition, leases and government grants. It is important that we update IAS 37 now to avoid conclusions in other projects being rejected on the basis that they are inconsistent with IAS 37 and/or that obligations with less than probable outflows do not satisfy the definition of a liability.
8. In light of the comments noted in paragraph 2(a), the staff believes that we need to revisit the Board's previous conclusions and reflect on what we have learned in the last year before proceeding to the next stage of this project.

#### **Staff comment**

##### *'Contingent liabilities'*

9. The staff thinks that the Board's subsequent redeliberations on issues associated with the proposal to eliminate the term 'contingent liability' add weight to the arguments in paragraph 7(a). These redeliberations emphasised that the notion of a 'contingent liability' is inconsistent with the *Framework's* definition of a liability, as well as the guidance in other standards such as business combinations. Specifically:
- (a) some items described as contingent liabilities (unrecognised present obligations) satisfy the *Framework's* definition of a liability. There may be uncertainty about the amount or timing of the future outflows required to settle the liability. But there is no uncertainty about the existence of a present obligation that is capable of requiring a future outflow of economic benefits. In other words, the obligation itself is non-contingent (or unconditional).

- (b) some items described as contingent liabilities (possible obligations) do not satisfy the *Framework's* definition of a liability. The *Framework* clearly states that the existence of a *present* obligation is an essential characteristic of a liability. It is therefore mis-leading to describe *possible* obligations as liabilities, even with the modifier 'contingent'.
- (c) the very notion of a contingency is a carry forward from the predecessor standard to IAS 37 and pre-dates the definition of a liability in our current *Framework*. Our current *Framework* does not admit the notion of a contingency or a possible obligation. Paragraphs 60–64 of the *Framework* require an entity to determine whether a liability exists, *before* turning to recognition and measurement.<sup>3</sup>

10. [Paragraph omitted from the observer notes]

*A building block for other projects*

- 11. The staff also continues to believe that the Board's thinking about the definition of a liability developed in this project is an important building block for other projects. This is because much of the work in this project focuses on answering the following question: which transactions and events satisfy the definition of a liability? Answering this question is an important building block because it may influence the way we analyse items and apply the definition of a liability more widely than just IAS 37. But the question is particularly pertinent in the context of IAS 37 because it is typically most difficult to determine whether the definition of a liability is satisfied for items potentially within the scope of this standard, such as lawsuits.

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<sup>3</sup> Before IAS 37, the accounting for contingencies was addressed in IAS 10 *Contingencies and Events Occurring after the Balance Sheet Date*. This version of IAS 10 dated back to 1978, 11 years before IASC defined a liability in the *Framework*. Therefore, unsurprisingly, IAS 10 analysed contingencies by considering whether transactions or events had given rise to potential *losses* that should be recognised in the income statement, rather than by considering whether the transactions or events had given rise to *liabilities* that should be recognised in the balance sheet. It is also worth mentioning that the IAS 10 approach was derived from FASB Statement No. 5 *Accounting for Contingencies*, a standard that is still in place but was issued before the FASB had defined a liability in its own conceptual framework.

12. *[Paragraph omitted from the observer notes]*

## **Conclusion**

13. Based on the analysis above, asks the Board to affirm the project objectives. However, participants' questions at the round-tables suggest that our past attempts to explain why we think this project is important have failed to convince *all* of our constituents. In the next stage of this project the staff proposes working with our communications team to identify opportunities to improve the way we communicate the Board's motivation for undertaking this project (as well as improving the way we communicate the tentative conclusions resulting from work to date).

## **SECTION 2: ISSUES REQUIRING FURTHER RESEARCH AND DEBATE**

14. In this section the staff analyses the feedback received during the round-tables on the Board's tentative conclusions on issues associated with the proposed liability recognition and measurement principles. The purpose of this analysis is to identify those issues requiring further research and debate in the next stage of this project (open issues). *[End of paragraph omitted from the observer notes]*

15. *[Beginning of paragraph omitted from the observer notes]*. The staff recommends reading appendix A in conjunction with this section.

### **Main issues requiring further research and debate**

16. The staff believes that there four main issues requiring further research and debate in the next stage of this project:

(a) which transactions and events satisfy the definition of a liability?

*[Sentence omitted from the observer notes]* In particular, the Board should pursue its efforts to distinguish between a liability and a business risk. The staff also notes that addressing this issue may help the Board progress its work in other projects.

- (b) can we reflect all uncertainty about the outflow of economic benefits required to settle a liability in measurement? *[End of paragraph omitted from the observer notes]*.
  - (c) what are we trying to achieve with regards to measurement in this project? *[End of paragraph omitted from the observer notes]*
  - (d) lawsuits. *[End of paragraph omitted from the observer notes]*
17. The staff is not asking the Board to conclude on any of these issues at this meeting (or on any of the other open issues identified in appendix A). However, the staff asks if there any other issues the Board believes require further research and debate in the next stage of this project?

### **SECTION 3: OUR OVERALL APPROACH**

18. In this section the staff considers whether we should continue working on the open issues identified in section 2 in the context of IAS 37, or jointly with other projects. Specifically the staff considers the conceptual framework, revenue recognition and insurance projects.

#### **Conceptual framework project**

19. There are undeniable links between the Board's thinking on the definition of a liability in this project and its work in Phase B of the conceptual framework project (elements and recognition). As noted above, the staff thinks that defining the boundary between a liability and a business risk is an important next step for this project. *[End of paragraph omitted from the observer notes]*
20. The staff has already acknowledged the relationship between the IAS 37 and the conceptual framework project and made efforts to ensure that the conceptual framework team is aware of the thinking about the definition of a liability developed in this project. For example, in November last year IASB staff updated the FASB Board and staff of this project. Members of the FASB also participated in and observed the round-table discussions in Norwalk. The timing of work on

distinguishing between a liability and a business risk is particularly opportune because the conceptual framework team plans to re-start its work on the definition of a liability this month. Staff from both projects will participate a joint brainstorming session to share ideas on distinguishing between a liability and a business risk. The Board meeting schedule for Q1 2007 allows for further interaction between the two projects with a view to continued interaction, while avoiding duplication of Board time.

21. However, after considering our overall approach to the next stage of this project in light of the outcome of the round-table discussions as a whole, the staff does not propose pursuing other open issues jointly with the conceptual framework team. *[End of paragraph omitted from observer notes]*
22. In reaching this conclusion, the staff first noted that there are important aspects of this project that are standards level issues, not conceptual issues. Specifically the staff considered:
  - (a) uncertainty about the existence of a present obligation. Clarifying the definition of a liability at a concepts level is unlikely to resolve this issue and eliminate the need for further guidance. Moreover, based on our work to date and the feedback received at the round-tables, we think that uncertainty about the existence of a present obligation most typically arises in non-contractual situations. In IFRS literature most non-contractual obligations are within the scope of IAS 37, therefore continuing work at a standards level is more appropriate.
  - (b) omitting the probability recognition criterion from IAS 37. As noted in section 2, the staff is proposing to consider whether all uncertainty about the outflow of economic benefits associated with a liability can be reflected in measurement, or whether a separate probability recognition criterion is needed to address the uncertainty associated with some or all of the liabilities within the scope of IAS 37. This is a standards level issue.



- (c) measurement. As noted in appendix A, the staff is not proposing to fundamentally reconsider the IAS 37 measurement objective as part of this project. The Board has gone to some lengths in the exposure draft and during redeliberations to emphasise that it is trying to clarify, not change, the existing measurement guidance in IAS 37. Determining the appropriate level of guidance is a standards level issue.
23. Secondly, the staff referred back to the Board's previous discussions on the interaction between this project and the conceptual framework project when it started redeliberating the ED. In February 2006 the Board noted that (a) the conceptual framework project is a long-term project and that its other standard-setting efforts should not await its completion; and (b) its thinking at the concepts level and at a standard level are not mutually exclusive and are expected to benefit each other.

### **Revenue recognition project**

24. As noted in agenda paper 4A, paragraph 11, some participants suggested that the Board amend IAS 37 by moving product warranties for which no consideration is received into IAS 18 *Revenue* and then continue its work in the context of the revenue recognition project (leaving all other aspects of IAS 37 unchanged).
25. The staff does not propose adopting this approach because, typically, there is little doubt that an entity's performance obligation under a product warranty satisfies the definition of a liability. The staff is not wishing to dismiss the possibility that, ultimately, all product warranties will be within the scope of one standard. But in the short-term, the staff thinks pursuing this project in the context of the revenue recognition project is unlikely to help the Board progress its work towards identifying which transactions and events satisfy the definition of a liability, or resolving the other open issues identified in section 2.

## **Insurance project**

26. The staff does not proposing conducting the next stage of this project in the context of the insurance project. This is because there is rarely any uncertainty that an insurance contract gives rise to a liability. Certainly there are important links between insurance project's work on measurement and IAS 37, especially on the components of an expected value calculation. But participants concerns about the Board's measurement proposals in the IAS 37 ED centre around single obligations which are less frequently faced by an insurance company.

## **SECTION 4: PROVISIONAL PROJECT TIMETABLE**

27. A provision project timetable is outlined in appendix B. The timetable is based on the staff's proposals in this paper. *[End of paragraph omitted from the observer notes]*
28. *[Paragraph omitted from the observer notes]*

**APPENDIX A: Staff analysis of the outcome of the round-table discussions**

This table follows the order of the discussion questions posed at the round-tables and cross-refers to the summary of outcomes in agenda paper 4A.

<b>Agenda paper 4A para. ref.</b>	<b>Issue</b>	<b>Staff analysis</b>	<b>Open or closed?</b>
13-14	The Board’s approach to redeliberating the definition of a liability	The staff plans to continue following the Board’s existing approach in the next stage of this project.  <i>[Further detail omitted from the observer notes]</i>	Closed

Agenda paper 4A para. ref.	Issue	Staff analysis	Open or closed?
16	Distinguishing between a liability and a business risk	<p>The staff plans to address this issue in the next stage of this project.</p> <p><i>[Further detail omitted from the observer notes]</i></p>	Open
<b>EXISTENCE OF A PRESENT OBLIGATION</b>			
<b>Uncertainty about the existence of a present obligation</b>			
16-17	The need for additional guidance	<p>The staff continues to believe that any final standard needs to include more guidance to help an entity determine whether a present obligation exists on the balance sheet date.</p> <p><i>[Further detail omitted from the observer notes]</i></p>	Closed
18-22	The form of any additional guidance	<p>First, the staff plans to refine our thinking about what ‘element certainty’ means and when it exists.</p> <p>Second, the staff plans to spend more time considering indicators before dismissing indicators as an option.</p> <p>Third, the staff plans to evaluate the need for a ‘more likely than not’ criterion in addition to, or as an alternative to, indicators.</p> <p><i>[Further detail omitted from the observer notes]</i></p>	Open

Agenda paper 4A para. ref.	Issue	Staff analysis	Open or closed?
23	Constructive obligations	<p>The staff plans to include constructive obligations in its work on uncertainty about the existence of a present obligation.</p> <p><i>[Further detail omitted from the observer notes]</i></p>	Open
<b>Lawsuits</b>			
24-25	General comments on lawsuits	<p>The staff plans to consider an exception to either the proposed recognition principle or the measurement principle (or both) for lawsuits following further discussions on the need for a probability recognition criterion and measurement.</p> <p>In July 2006 the Board confirmed that it intends to retain the prejudicial disclosure exemption in IAS 37. The staff does not propose re-opening this issue.</p> <p><i>[Further detail omitted from the observer notes]</i></p>	Open
26-27	Start of legal proceedings	<p>The staff does not propose debating this topic further.</p> <p><i>[Further detail omitted from the observer notes]</i></p>	Closed
28-32	External detection	<p>The staff acknowledges that we need to improve the way we explain this point, but does not believe this requires additional Board time.</p> <p><i>[Further detail omitted from the observer notes]</i></p>	Closed

Agenda paper 4A para. ref.	Issue	Staff analysis	Open or closed?
<b>UNCERTAINTY ABOUT AN OUTFLOW OF ECONOMIC BENEFITS</b>			
<b>The phrase ‘expected to’ in the definition of a liability</b>			
34-35	Is a degree of certainty about an outflow of economic benefits required before an item satisfies the definition of a liability?	The staff does not propose further debate on this issue in the context of this project.  <i>[Further detail omitted from the observer notes]</i>	Closed
36	Inconsistent language in IFRS literature	The staff does not plan to address this issue as part of this project.  <i>[Further detail omitted from the observer notes]</i>	Closed
<b>Probability recognition criterion</b>			
37	No probability recognition criterion is needed	The staff does not propose further debating the <i>conceptual</i> merits of the Board’s proposal in the next stage of this project. (See box below)  <i>[Further detail omitted from the observer notes]</i>	Closed

Agenda paper 4A para. ref.	Issue	Staff analysis	Open or closed?
39-40 and 45	A probability recognition criterion is needed for practical reasons	The staff plans to discuss whether <i>all</i> uncertainty about <i>all</i> liabilities within the scope of IAS 37 can be reflected in measurement alone. Or, whether uncertainty needs to be addressed through a combination of recognition and measurement and that combination will vary depending on the liability in question.	Open
41-43	A probability criterion is needed because liabilities within the scope of IAS 37 are different to liabilities within the scope of other standards	<i>[Further detail omitted from the observer notes]</i>	
44	Inconsistency with the <i>Framework</i>	The staff does not propose further work on this point in the context of this project.  <i>[Further detail omitted from the observer notes]</i>	Closed
<b>RELATED AMENDMENTS</b>			
46	Eliminating the	The staff does not propose further debate on this point.	Closed

Agenda paper 4A para. ref.	Issue	Staff analysis	Open or closed?
	term 'contingent liability	<i>[Further detail omitted from the observer notes]</i>	
47-48	Loss of disclosures about items currently described as possible obligations	The staff plans to use both past Board discussions and the outcome of the round-tables to address this issue in the next stage of this project.  <i>[Further detail omitted from the observer notes]</i>	Open
49-51	Stand-ready obligations	The staff does not propose separately debating this issue in the next stage of this project.  <i>[Further detail omitted from the observer notes]</i>	Closed (as a stand-alone issue)
<b>MEASUREMENT</b>			
<b>Overall approach to redeliberations</b>			
52	Fundamentally reconsidering the IAS 37 measurement objective	The staff continues to believe that articulating a clear measurement objective is beyond the scope of this project.  <i>[Further detail omitted from the observer notes]</i>	Closed



Agenda paper 4A para. ref.	Issue	Staff analysis	Open or closed?
53	Interaction between recognition and measurement	See comments in the probability recognition section above.	Open (due to link with recognition)
<b>The measurement principle</b>			
55-58	IAS 37 is not a current settlement notion	The staff proposes focusing on those aspects of the existing standard which are critical to the Board's work on other aspects of this project.  <i>[Further detail omitted from the observer notes]</i>	Open
59-61	There is a difference between 'amount to settle' and amount to transfer'		
<b>Useful information about liabilities within the scope of IAS 37</b>			
64-70	Expected value vs. individual most likely	The staff thinks that we need to consider this issue in conjunction with the need for a separate probability recognition criterion in IAS 37.  <i>[Further detail omitted from the observer notes]</i>	Open

Agenda paper 4A para. ref.	Issue	Staff analysis	Open or closed?
	outcome		
<b>Guidance on how to apply the proposed measurement principle</b>			
71-72 and 77-78	Practical application difficulties	The staff proposes to bring this issue back to the Board in the next stage of this project.  <i>[Further detail omitted from the observer notes]</i>	Open
73-76	Methodology		
79	Meaning of 'reliable' measurement		
<b>OTHER COMMENTS</b>			
80-81	Due process procedures	Following the 'comply or explain' approach in the <i>IASB Due Process Handbook</i> , the Board will need to debate the cost-benefits of its proposals and consider field-tests and/or re-exposure in the next stage of this project.	Open

For completeness, the staff notes that the Board will also start redeliberating issues associated with its proposed amendments to contingent assets and reimbursement rights; disclosure of measurement uncertainty; and the amendments resulting from short-term convergence (restructuring provisions, onerous contracts, constructive obligations and termination benefits) in the next stage of this project.

## APPENDIX B: Provision project timetable

Board meeting	Meeting type	Issue
January 2007	Board	<b>Round-table discussions debrief</b> <ul style="list-style-type: none"> <li>▪ Summary of outcomes</li> <li>▪ Planning the next stage of this project</li> </ul>
March 2007	Board	<b>The definition of a liability</b> <ul style="list-style-type: none"> <li>▪ Distinguishing between a liability and a business risk (including stand ready obligations)</li> </ul>
April 2007	Board	<b>Uncertainty about the existence of a present obligation</b> <ul style="list-style-type: none"> <li>▪ Defining element uncertainty (including constructive obligations)</li> <li>▪ Draft indicators</li> </ul>
May 2007	Board	<b>Uncertainty about the existence of a present obligation</b> <ul style="list-style-type: none"> <li>▪ Refining indicators and/or evaluating the need for a 'more likely than not' threshold</li> <li>▪ Other issues arising from the proposed amendments to constructive obligations (moved forward from short-term convergence amendments)</li> </ul>
September 2007	Board	<b>Probability recognition criterion</b> <ul style="list-style-type: none"> <li>▪ Can all uncertainty about the outflow of economic benefits required to settle a liability be reflected in measurement (including lawsuits)?</li> </ul>
December 2007	Board	<b>Measurement</b> <ul style="list-style-type: none"> <li>▪ Reconsidering our approach to measurement</li> <li>▪ The measurement principle</li> <li>▪ Guidance on how to use expected value (including lawsuits)</li> </ul>
February 2008	Board	<b>Disclosure</b> <ul style="list-style-type: none"> <li>▪ Items that do not satisfy the definition of a liability on the balance sheet date</li> <li>▪ Other issues associated with the proposed disclosure requirements</li> </ul>
March 2008	Board	<b>Contingent assets &amp; reimbursement rights</b> <ul style="list-style-type: none"> <li>▪ Guidance on assets formerly described as contingent assets</li> <li>▪ Measurement guidance for reimbursement rights</li> </ul>
April 2008	Board	<b>Short term convergence amendments</b> <ul style="list-style-type: none"> <li>▪ Application guidance for restructuring costs in IAS 37</li> <li>▪ Application guidance for onerous contracts</li> <li>▪ Termination benefits</li> </ul>
June 2008	Board	<b>Due process procedures</b> <ul style="list-style-type: none"> <li>▪ Cost-benefit analysis</li> <li>▪ Need for field tests/visits</li> <li>▪ Need for re-exposure</li> </ul>

<b>Board meeting</b>	<b>Meeting type</b>	<b>Issue</b>
July 2008	Board	<b>Other issues</b> <ul style="list-style-type: none"><li>▪ Final form (IAS or IFRS)</li><li>▪ Effective date &amp; transition requirements</li></ul>
August – October 2008		<b>Drafting and balloting</b>