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International
Accounting Standards
Board

INFORMATION FOR OBSERVERS

Board Meeting:	**20 July 2007, London**
Project:	**Liabilities - amendments to IAS 37**
Subject:	**IAS 37 Redeliberations: distinguishing a liability from a business risk, including stand ready obligations (Agenda paper 10A)**

INTRODUCTION

1. This paper summarises the Board's previous discussions on distinguishing a liability from a business risk, including stand ready obligations.

2. The paper divides into three sections:

    A. Re-capping the proposals and feedback received

    B. Distinguishing a liability from a business risk

    C. Stand ready obligations

A. RE-CAPPING THE PROPOSALS AND FEEDBACK RECEIVED[1]

Proposals

3. The IAS 37 ED introduces the term 'stand ready obligation' and explains that 'in some cases, an entity has a liability even though the amount that will be required to settle that liability is contingent (or conditional) upon the occurrence or non-occurrence of one or more uncertain future events. In such cases, an entity has incurred two obligations as a result of an event – an unconditional and a conditional obligation.' The term 'stand ready obligation' describes this type of liability.[2]

4. The text of the ED includes two examples of a stand ready obligation: a product warranty and a lawsuit. The Illustrative Examples accompanying the ED develop these examples, plus additional examples of stand ready obligations.

Feedback received

5. In their comment letters many respondents agreed that the notion of a stand ready obligation applies to contracts. However, a majority of respondents articulated two concerns:

    (a) the notion of a stand ready obligation is not appropriate for non-contractual situations. Applying the ED's description of a stand ready obligation to non-contractual situations may result in an entity recognising limitless liabilities, including items currently regarded as business risks.

    (b) they disagreed with the Board's conclusion that the start of legal proceedings gives rise to a present obligation because an entity 'stands ready' to act as the court directs.

[1] For more detail see agenda paper 10D discussed in May 2006, agenda paper 3B discussed in June 2006, section C of the background materials prepared for the IAS 37 round-tables and agenda papers 4A and 4B discussed in January 2007.
[2] IAS 37 ED, paragraphs 22-26.

Non-contractual situations

6. In light of constituents' comments, the Board began redeliberations by emphasising that an item described as a 'stand ready obligation' must satisfy the definition of a liability. The term 'stand ready obligation' is then used to describe liabilities for which the outflow of benefits is a service provided from inception, regardless of the occurrence (or non-occurrence) of a future event. The Board also directed the staff to expand the ED's explanation of a stand ready obligation to clarify the boundary between a liability and a business risk.

7. At the IAS 37 round-tables, a majority of participants supported the Board's intention to clarify the boundary between a liability and a business risk. Several commented that it is critical to identify when and why a past event(s) gives rise to a present obligation. However, views on applying the notion of a stand ready obligation in non-contractual situations remained mixed.

Lawsuits

8. In June 2006 the Board reconsidered lawsuits and tentatively agreed that the conclusion in the IAS 37 ED is incorrect. In other words, the start of legal proceedings, in itself, does not obligate an entity. Rather, the start of legal proceedings is another piece of evidence that an entity evaluates in determining whether a liability exists for the item that is the subject of a lawsuit. The Board also observed that the start of legal proceedings usually means that it is highly likely an entity will incur legal costs. However, the Board tentatively concluded that no liability exists because an entity is not *presently* obliged to incur *future* legal costs.

9. Most round-table participants welcomed the Board's decision to change the conclusion in the ED. However, a few participants in Norwalk argued that the start of legal proceedings obliges an entity to defend itself therefore an entity should at least recognise a liability, measured by reference to estimated legal

costs. In January 2007 the Board acknowledged that this view but tentatively affirmed its revised conclusion, as outlined in paragraph 8.

10. Paper 10B discusses how to resolve uncertainty about whether a liability exists for an item that is the subject of a lawsuit or other type of dispute. Consequently, this paper does not consider lawsuits further.

B. DISTINGUISHING A LIABILITY FROM A BUSINESS RISK[3]

Recent Board discussions

11. In March 2007 the Board tentatively concluded that the existence of a present obligation distinguishes a liability from a business risk. The Board also noted that:

- the occurrence of a past event distinguishes a liability from a business risk. A present obligation arises after something *has* happened. In contrast, a business risk is something that *might* happen in the future as a result of conditions that exist on the balance sheet date.

- a potential outflow of economic benefits does not distinguish a liability from a business risk because both are capable of resulting in an outflow of economic benefits. Earlier in redeliberations, the Board tentatively affirmed that the phrase 'expected to' in the current definition of a liability does not require a particular degree of certainty that an outflow of economic benefits will occur. In short, more than 0% is enough.[4]

12. The Board went on to note that, according to the *Framework*, a present obligation is a duty or responsibility to act or perform in a particular way. Also, a present obligation normally arises when an entity enters into an irrevocable agreement

[3] For more detail see agenda paper 3A discussed in March 2007.
[4] This observation affirmed the Board's tentative conclusion in May 2006, see agenda paper 10B.

that leaves the entity with little, if any, discretion to avoid an outflow of economic resources.[5] According to the current IAS 37, a present obligation:

- results from a past event, sometimes described as an obligating event. A past event is an obligating event when an entity has no realistic alternative to settling the obligation. For example, when either settlement is legally enforceable, or when the entity creates a valid expectation (that other parties can reasonably rely on) that it will discharge the obligation.

- exists independently of the entity's future actions. An intention to incur an outflow of economic benefits is not sufficient to give rise to a present obligation.

- always involves another party, although it is not necessary for an entity to know the identity of the other party.[6]

13. In contrast, the Board observed that a business risk arises from where, when and how an entity conducts its operations. Business risks are inherent in any organisation. For example, an entity selling goods overseas faces the risk of variable cash flows as a result of future exchange rate movements. But this risk is not a liability because the entity is not presently obliged to bear that risk or to incur a future outflow of economic benefits.

14. In March 2007, the Board discussed a series of examples developed by the staff to illustrate the difference between a present obligation and a business risk – see appendix A for a reminder. The extract below summarises the Board's tentative conclusions after considering these examples. The summary also includes some alternative words, responding to subsequent feedback received from the Board and other members of staff.

[5] *Framework*, paragraphs 60-61.
[6] IAS 37, paragraphs 17-20 and IAS 37 ED, paragraphs 17-19.

A present obligation exists when an entity is ~~irrevocably committed~~ presently bound to act in a particular way. As a result, an external party has a~~n enforceable~~ right to call upon the entity to act in a particular way. Consequently:

- an ~~irrevocable~~ action or event, by itself, does not give rise to a present obligation. A mechanism that establishes an external party's right to call upon the entity is also required.
- a law (including contract law), by itself, does not give rise to a present obligation. An ~~irrevocable~~ action or event is also required. However, laws are examples of mechanisms that may establish an external party's right to call upon the entity to act in a particular way.
- a ~~revocable~~ non-binding action or event in a jurisdiction where there is a mechanism that establishes an external party's right to call upon the entity to act in a particular way does not give rise to a present obligation.
- planning a future ~~irrevocable~~ binding action or event in a jurisdiction where there is a mechanism that establishes an external party's right to call upon the entity to act in a particular way does not give rise to a present obligation.

Using the tentative conclusions to date

15. The staff thinks that we could use the Board's tentative conclusions to date to amend paragraphs 12, 13 and 17-19[7] of the ED to read something along the lines of:

Satisfying the definition of a liability

12 Items are recognised as ~~non-financial~~ liabilities in accordance with this [draft] Standard only if they satisfy the definition of a liability in the *Framework*.[8]

Present obligation

[7] Paragraphs 14-16 of the IAS 37 ED discuss uncertainty about the existence of a present obligation and constructive obligations. This paper does not cover those topics.

[8] In this draft text the staff identifies two essential characteristics of a liability: a present obligation and an expected outflow of economic resources. Concepts Statement 6 identifies three essential characteristics: (a) a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. Although expressed differently, the staff thinks that the characteristics described in Concepts Statement 6 are consistent with the staff's description of present obligations and an expected outflow of economic resources in this draft text.

13 The first ~~An~~ essential characteristic of a liability is that the entity has a present obligation ~~arising from a past event~~. ~~For a past event to give rise to a~~ An ~~present~~ *obligation* exists when an entity ~~must have~~ has little, if any, discretion to avoid acting or performing in a particular way. ~~settling it~~.

14 …

15 …

16 …

17 A *present* obligation exists independently of the entity's future. Consequently, a present obligation arises only after a transaction or event. A ~~past~~ transaction or event that creates a present obligation is sometimes referred to as an obligating event. ~~17 Only present obligations arising from past events existing independently of an entity's future actions (ie the future conduct of its business) result in liabilities~~. For example, an entity ~~has a liability for its obligation to decommission~~ operating an oil installation or a nuclear power station in a jurisdiction with environmental rehabilitation laws may have a present obligation to ~~the extent that the entity is obliged to~~ rectify damage already caused to the environment by its past operating activities. However, the entity does not have a present obligation to rectify damage caused to the environment as a result of future operating activities, even if the entity expects it future operating activities to cause further damage. ~~Regardless of its future actions, the entity has little, if any, discretion to avoid settling that obligation. 18~~ It therefore follows that ~~A~~an intention to incur an outflow of economic resources embodying economic benefits in the future is not sufficient to give rise to a present obligation ~~liability,~~ even if the outflow is necessary for the continuation of the entity's future operations. ~~For example, because of commercial pressures or legal requirements, an entity may intend or need to incur expenditure to operate in a particular way in the future (for example, by installing smoke filters in a particular type of factory). Because the entity has the discretion to avoid the future expenditure by its future actions, for example by changing its operations, it has no present obligation for that future expenditure and a liability does not exist.~~

18 A past transaction or event, by itself, does not give rise to a present obligation. ~~19~~ A present obligation always involves an~~other~~ external party to whom the obligation is owed. Moreover, that external party must have a right to call upon the entity to act or perform in a particular way. Without that right, the entity has discretion to avoid settling a present obligation. ~~It is not necessary, however, to know the identity of the specific party to whom the obligation is owed – indeed, the obligation may be to the public at large. Because a liability always involves an obligation to another party, it follows that a decision by the management of an entity does not normally give rise to a present obligation at the balance sheet~~

~~date. A present obligation arises only if the decision has been communicated before the balance sheet date to those it affects in a sufficiently specific manner to raise a valid expectation in them that they can reasonably rely on the entity to perform.~~

<u>*Outflow of economic benefits*</u>

<u>19</u> <u>The second essential characteristic of a liability is an expected outflow from the entity of resources embodying economic benefits to settle a present obligation.</u>

<u>19A</u> <u>In this context, the phrase 'expected' does not require a particular degree of certainty about the outflow of resources embodying economic benefits before an item satisfies the definition of a liability.</u>

<u>*Distinguishing a liability from a business risk*</u>

<u>19B</u> <u>Business risks result from when, where and how an entity conducts its operations. Business risks may result in an outflow from the entity of resources embodying economic benefits.</u>

<u>19C</u> <u>However, a business risk is not a liability because a risk lacks the first essential characteristic of a liability: a present obligation. For example, an entity selling goods overseas faces the risk of fluctuating cash flows because of future changes in foreign exchange rates. But the entity is not *presently* obliged to incur an outflow of resources embodying economic benefits as a result of that risk.</u>

Unresolved issues

16. The staff has identified two unresolved issues:

'Little, if any, discretion'

17. Paragraph 13 of the proposed text uses the phrase 'little, if any, discretion' to describe when and why an entity is presently obligated. This phrase comes from the *Framework*. However, the staff thinks that 'little, if any, discretion to avoid' is ambiguous - how little is 'little'? In a worse-case scenario, an entity might use this ambiguity to justify recognising as a liability an item with a certain outflow of economic benefits, but no present obligation.

18. In recent board papers the staff has tried to resolve this ambiguity by using more emphatic phrases to describe when and why an entity is presently obligated such as 'irrevocably committed', 'no discretion' and 'something an entity cannot

avoid'). Admittedly, using one of these phrases would create tension with the words in the *Framework*, but

(a) the Board has already acknowledged that the *Framework* is not immutable. Indeed, the IAS 37 ED excludes a probability recognition criterion – a proposal that undoubtedly creates tension with the *Framework*[9]; and

(b) using a more emphatic phrase to describe when and why an entity is presently obligated would help distinguish a liability from a business risk. It would also help resolve some of the issues associated with constructive obligations (see paper 10C).

19. However, the staff is concerned that replacing the phrase 'little, if any, discretion' with a more emphatic phrase in any final standard may require re-exposure. (For reference Appendix B lists the criteria for re-exposure). *Remainder of paragraph omitted from observer notes.*

20. Additionally, replacing 'little, if any, discretion' with a more emphatic phrase in this project could set an unintended precedent for other projects dealing with liabilities. For example, for unvested benefits in phase 2 of the Employee Benefits project and make good clauses in a lease contract in the Leasing project.

21. Therefore, on balance, the staff does *not* propose replacing the phrase 'little, if any, discretion' with a more emphatic phrase in any final standard. Instead the staff recommends outlining the above discussion in the Basis for Conclusions accompanying any final standard and, where possible, replacing the phrase 'little, if any, discretion' with other phrases already in *Framework* in the text of any final standard. For example, 'little, if any, discretion' in paragraph 13 of the proposed text could be replaced with 'a duty or responsibility to act or perform in a particular way' (taken from paragraph 60 of the *Framework*).

[9] Following the round-tables, the Board has agreed to consider re-instating a probability recognition criterion for at least some liabilities within the scope of IAS 37. The Board has not yet discussed this issue.

Does the Board agree?

Mechanisms that establish an external party's right

22. Paragraph 18 of the proposed text refers to 'mechanisms that establish an external party's right to call upon the entity to act or perform in a particular way'. To date, the Board has agreed that the legal system is an example of a mechanism that establish an external party's right to call upon an entity to act in a particular way. However, the Board has also acknowledged that the current *Framework's* description of a present obligation and IAS 37 also admit items that are not legally enforceable. That is, items we often describe as constructive obligations. Paper 10C considers constructive obligations in more detail.

Are there any other unresolved issues associated with distinguishing a liability from a business risk that the Board would like the staff to analyse further as part of the IAS 37 project?

C. STAND READY OBLIGATIONS[10]

Recent Board discussions

Distinguishing a stand ready obligation from a business risk

23. In March 2007, the Board affirmed its previous observation: a stand ready obligation must satisfy the definition of a liability (see paragraph 6). Logically, therefore, the existence of a present obligation distinguishes a stand ready obligation from a business risk for the same reasons that the existence of a present obligation distinguishes a liability from a business risk.

[10] For more detail see agenda paper 3B discussed in March 2007 and agenda paper 7 discussed in May 2007.

24. In May 2007, the Board also affirmed that the term 'stand ready obligation' describes situations when an entity has an unconditional obligation associated with a conditional obligation[11] using two examples:

Product warranty

On 1 December 200X Retailer sells a product warranty that requires him to repair Customer's product if it breaks down during the warranty period. The warranty is non-cancellable and expires on 31 May 200Y. The balance sheet date is 31 December 200X. Customer has not yet reported any break downs.

Written option

On 1 December 200X Farmer writes an option that requires him to deliver 1000 bushels of corn to Canner for $3 per bushel if Canner exercises the option. The option is non-cancellable and expires on 31 May 200Y. The balance sheet date is 31 December 200X. Canner has not yet exercised the option.

	Unconditional obligation	**Conditional obligation**
Retailer	Provide warranty coverage until 31 May 200Y.	Repair Customer's product *if* it breaks down during the remainder of the warranty period.
Farmer	Protect the price and availability of 1000 bushels of corn until 31 May 200Y.	Deliver 1000 bushels of corn for $3 per bushel *if* Canner exercises the option before 31 May 200Y.

25. The Board also noted that, in both examples, there is potentially more than one unconditional obligation. For example, Retailer may have an unconditional obligation (a present obligation) to repair Customer's product as a result of a break down that occurred before the balance sheet date, but has not yet been

[11] The Basis for Conclusions (paragraph BC11) explains that an unconditional obligation exists when 'nothing other than the passage of time is required to make its performance due'. A conditional obligation exists when 'performance is subject to the occurrence of an event that is not certain to occur'.

reported. But we could not describe this unconditional obligation as a ‘stand ready obligation’ because it is not accompanied by a conditional obligation.

Distinguishing a stand ready obligation from uncertainty about the existence of a present obligation

26. In May 2007 the Board discussed how to distinguish a stand ready obligation from uncertainty about the existence of a present obligation by contrasting the two examples above with the following fact pattern:

- On the balance sheet date Vendor sold one hamburger in a jurisdiction where the law states that the vendor must pay compensation of £100,000 to each customer that purchases a contaminated hamburger.
- Past experience indicates that one in a million hamburgers sold by the entity are contaminated. No other information is available.

27. The Board tentatively agreed that the hamburger example illustrates uncertainty about the existence of a present obligation because paying compensation is the potential *consequence* of a *past* transaction. This is not an example of a stand ready obligation because there is no conditional *future* event that may or may not occur.

Applying to non-contractual situations

28. In March 2007 the Board agreed that contractual situations provide the clearest and most frequent examples of situations that can be described as ‘stand ready obligations’. However, the Board also tentatively concluded that the term ‘stand ready obligation’ also applies to non-contractual situations.

29. The Board noted that this tentative conclusion is consistent with its observations on the attributes of a present obligation (see paragraph 14). That is to say, contracts represent just one type of legal mechanism that establishes an external party’s right to call upon the entity to act in a particular way. But the form of the

mechanism should not influence whether an unconditional and conditional obligation exists. Statutes are also examples of legal mechanisms that establish an external party's right to call upon the entity to act in a particular way and may also give rise to unconditional and conditional obligations. Therefore the term 'stand ready obligation' applies to non-contractual situations too.

Using the tentative conclusions to date

30. The staff thinks that we could use the Board's tentative conclusions to date to amend paragraphs 22-26 of the ED to read something along the lines of:

Uncertainty about the amount required to settle a present obligation

~~***Contingencies***~~

22 In some cases, ~~an entity has a liability even though~~ the amount that will be required to settle ~~that~~ a present obligation ~~liability~~ is contingent (or conditional) on~~ the occurrence or non-occurrence of~~ one or more uncertain future events that may or may not occur regardless of the entity's actions. ~~In such cases, an entity has incurred two obligations as a result of a past event – an unconditional obligation and a conditional obligation.~~

~~23 When the amount that will be required to settle a liability is contingent on the occurrence or non-occurrence of one or more uncertain future events, the liability arising from the unconditional obligation is recognised independently of the probability that the uncertain future event(s) will occur (or fail to occur). Uncertainty about the future event(s) is reflected in the measurement of the liability recognised.~~

~~24~~ ~~Liabilities~~ These situations ~~for which the amount that will be required in settlement is contingent on the occurrence or non-occurrence of a future event~~ are sometimes described ~~referred to~~ as 'stand ready' obligations. ~~This is because the entity has an unconditional obligation to stand ready to fulfil the conditional obligation *if* the uncertain future event occurs (or fails to occur). The liability is the unconditional obligation to provide a service, which results in an outflow of economic benefits.~~

23~~25~~ An example of a stand ready obligation is an extended product warranty. The issuer of a non-cancellable product warranty has a~~n~~ present ~~unconditional~~ obligation ~~to stand ready to~~ ~~repair or replace the product (or, expressed another way,~~ to provide ~~warranty coverage~~ a service over the term of the warranty~~)~~. However, the amount that will be required to provide that service is conditional upon the product developing a fault during the warranty period - an uncertain future event that may or may not occur regardless of the issuer's future actions. ~~and a conditional obligation~~

~~to repair or replace the product if it develops a fault.~~ This uncertainty does not affect the existence of a present obligation and therefore does not prevent t~~T~~he issuer concluding that ~~recognises~~ its ~~liability arising from its unconditional~~ present obligation to provide warranty coverage satisfies the definition of a liability. Uncertainty about whether the product will require repair or replacement ~~(ie the conditional obligation)~~ is reflected in the measurement of the liability.

~~26 Similarly, an entity that is involved in defending a lawsuit recognises the liability arising from its unconditional obligation to stand ready to perform as the court directs. Uncertainty about the possible penalties the court may impose (ie the conditional obligation) is reflected in the measurement of the liability.~~

Unresolved issues

31. As noted above, the Board has tentatively concluded that the hamburger example illustrates uncertainty about the existence of a present obligation. The Board also agree that the question in this example is "did Vendor sell a contaminated hamburger?" However, the Board did not reach a consensus about how to address that uncertainty. Paper 10B considers how to address uncertainty about the existence of a present obligation.

Are there any other unresolved issues associated with stand ready obligations that the Board would like the staff to analyse further as part of the IAS 37 project?

APPENDIX A: Examples discussed by the Board to assist in distinguishing a liability from a business risk in March 2007 (agenda paper 3A)[12]

	Example	Tentative conclusion
1A	Digger has the right to mine in two jurisdictions. In Jurisdiction A environmental rehabilitation laws state that all mine shafts deeper than 10 metres must be entirely filled in by 31 December 2020 or the mining company that dug the holes for the shafts will be fined £100,000 per unfilled hole. Jurisdiction B has no environmental rehabilitation laws. On the balance sheet date Digger has not started mining in either jurisdiction. Assumption: Normal business practice in both jurisdictions does not create a valid expectation that Digger will fill-in holes that are less than 10 metres deep.	On the balance sheet date Digger does not have a liability because • Digger is not committed to mining in either jurisdiction, and • no external party has an enforceable right to call upon Digger to take an action as result of mining in either jurisdiction. In other words, Digger can simply walk away from the status quo on the balance sheet date. Digger is aware that there are potentially more costs associated with mining in Jurisdiction A. This may affect the *value* of Digger's right to mine in Jurisdiction A. But a right to mine in a jurisdiction that is subject to environmental rehabilitation laws does not give rise to a present obligation. Equally, the existence of a law, by itself, does not give rise to a present obligation. As a result, no liability exists on the balance sheet date.
1B	Facts as Example 1A, except that Digger has started mining in both jurisdictions. The geologists' reports indicate that Digger will be able to extract significant quantities of ore for at least 20 years in both jurisdictions. The ore is located 15 metres below the surface in both jurisdictions. On the balance sheet date Digger has mined five shafts in Jurisdiction A and five shafts in Jurisdiction B. Each shaft is 5 metres deep.	On the balance sheet date Digger does not have a liability in Jurisdiction A because each shaft is less than 10 metres deep. As a result: • Digger is not committed to fill-in the shafts that already exist, and • no external party has an enforceable right to call upon Digger to fill-in shafts that are less than 10 metres deep. Based on the facts outlined in this example, it is highly likely that Digger will mine beyond 10 metres *in the future* and therefore will be obliged to fill-in each shaft. However, a present *intention* to mine beyond 10 metres in the future is not the same as a present *obligation* as a

[12] The staff has slightly modified the fact pattern and analysis originally presented in March 2007 to reflect Board members' comments. The table also excludes example 3B. This is the hamburger example already discussed in section C of this paper.

	Example	Tentative conclusion
		result of mining beyond 10 metres. Digger can choose not to mine beyond 10 metres and no external party has an enforceable right to call upon Digger to mine beyond 10 metres. In other words, Digger can simply walk away from the status quo on the balance sheet date. On the balance sheet date Digger does not have a liability in Jurisdiction B because there are no environmental laws requiring Digger to fill-in any mine shafts, no matter how deep Digger has mined or how deep Digger intends to mine in the future.
1C	Facts as Example 1B, except that each shaft is 12 metres deep on the balance sheet date.	On the balance sheet date Digger has a liability in Jurisdiction A in respect of each shaft that is more than 10 metres deep. A present obligation exists because: • Digger is committed to fill-in the five shafts that already exist deeper than 10 metres, • Digger has no realistic alternative to filling-in those five shafts (or paying the fine), and • an external party has an enforceable right to call upon the Digger to fill-in the five shafts that already exist (or pay the fine). In other words, Digger can no longer walk away from the status quo on the balance sheet date. A liability exists because filling-in those shafts (or paying the fine) is expected to result in an outflow of resources embodying economic benefits. Based on the facts outlined in this example, it is highly likely that Digger will mine a further 3 metres *in the future* (to reach the ore) and therefore will be obliged to fill-in five 15 metre shafts. However, as noted in Example 1B, a present intention is not the same as a present obligation. Digger may choose not to mine a further 3 metres and no external party has an enforceable right to call upon Digger to mine a further 3 metres. Digger's liability is limited to that related to 12 metre holes. Digger does not have a liability in Jurisdiction B, for the same reasons given in Example 1B.
1D	Facts as Example 1C, except that the law in Jurisdiction A requires that all mine shafts deeper than 10 metres must be	On the balance sheet date Digger has a liability in Jurisdiction A, for the same reasons given in Example 1C.

	Example	Tentative conclusion
	entirely filled in within 2 years of ending mining operations	The staff acknowledges that Digger can choose *when* to cease mining each shaft and that no external party has an enforceable right to call upon Digger to fill-in the five shafts until he ceases mining. However, • Digger is committed to fill-in the five shafts that already exist because they are already more than 10 metres deep, • Digger has no realistic alternative to filling-in those five shafts in the future, and • an external party has an enforceable right to call upon Digger to fill-in the five shafts that already exist if he stops mining. In other words, Digger cannot walk away from the status quo on the balance sheet date, even though he can choose *when* to incur the outflow of resources embodying economic benefits to settle his obligation.
1E	Facts as Example 1C, except that Digger has offered to apply the same standards as in Jurisdiction A to both existing and future mine sites in Jurisdiction B if the local municipal council extends his right to mine in Jurisdiction B for another 15 years. According to the law in Jurisdiction B, *Digger's offer is not binding until accepted*. On the balance sheet date the municipal council has not accepted Digger's offer	On the balance sheet date Digger does not have a liability in Jurisdiction B because his offer is not binding until accepted. The municipal council has not accepted his offer. As a result: • Digger is not committed to fill-in the shafts that already exist and are deeper than 10 metres, • Digger can avoid this commitment by withdrawing his offer, and • no external party has an enforceable right to call upon Digger to fill-in shafts that already exist and are deeper than 10 metres.
1F	Facts as Example 1E, except that, on the balance sheet date, the municipal council has accepted Digger's offer	On the balance sheet date Digger has a liability in Jurisdiction B to fill-in the five shafts that already exist and are deeper than 10 metres, for the same reasons given in Example 1C. Digger does not have a liability to fill-in future mine shafts, for the same reasons given in Example 1B. In this example, the contract between Digger and the municipal council has the same effect as the law in Jurisdiction A because both the law in Jurisdiction A and the contract law in Jurisdiction B are mechanisms that establish an external party's right to call upon Digger to fill-in those shafts

	Example	Tentative conclusion
2A	Auto sells car breakdown services. Auto's standard services agreement states that Auto will repair all listed cars that breakdown within 12 months from the date the agreement is signed. Once signed, the services agreement is non-cancellable. Auto recently mailed standard services agreements to 50 drivers offering 12 months breakdown service, regardless of the current condition of the car if the driver returns a signed services agreement on or before 31 January 2011 for a fixed price. Auto cannot withdraw his offer because, according to the laws in this jurisdiction, *his offer is legally binding*. On 31 December 2010 no drivers have returned a signed services agreement. Assumption: no signed services agreements are in the post	On 31 December 2010 Auto has a liability because his offer is legally binding, therefore he cannot refuse to enter into a services agreement. As a result: • Auto is committed to accepted a signed standard services agreement if a driver returns a signed services agreement on or before 31 January 2011, • Auto cannot avoid this commitment because he cannot withdraw his offer or influence each driver's decision to return a signed agreement, and • each of those 50 drivers has an enforceable right to call upon Auto to sign a services agreement if they return a signed services agreement to Auto on or before 31 January 2011. Based on the facts in this example, it is not certain if any of the 50 drivers will return a signed services agreement. However, in effect, Auto has written an option. As a result, Auto has no realistic alternative but to accept any returned, signed services agreements. In other words, Auto cannot simply walk away from the status quo on the balance sheet date. Auto's present obligation satisfies the definition of a liability because his offer is for a fixed price. This means that Auto is exposed to changes in market price: a situation that is capable of resulting in an outflow of resources embodying economic benefits.
2B	Facts as Example 2A, except that on 31 December 2010 one driver has returned a signed services agreement listing one car used as part of his regular business operations. The period of the agreement is 1 December 2010 – 30 November 2011. On 31 December 2010 Driver's car does *not* require repair. Assumption: it is certain that Driver's car does not require repair – there are no incurred but not reported (IBNR) break downs requiring repair	On 1 December 2010 Auto made two promises to Driver. The first promise was to repair Driver's car if it breaks down on or before 30 November 2011. The second promise was to provide Driver with breakdown services. The services agreement does not resolve uncertainty about whether Driver's car will break down and require repair, but the agreement confirms that Auto has assumed that risk on Driver's behalf for a 12-month period. On 31 December 2010 Auto's first promise (to repair if car breaks down) does not satisfy the definition of a liability because Driver's car does not require repair. However, Auto's second promise (to provide breakdown services) satisfies the definition of a liability because: • Auto is committed to provide breakdown services Driver for another 11 months, • Auto has cannot avoid this commitment because the agreement is non-cancellable, and

	Example	Tentative conclusion
		• Driver has an enforceable right to call upon Auto to provide breakdown services for another 11 months. In other words, Auto cannot simply walk away from the status quo on the balance sheet date. Providing breakdown services for another 11 months satisfies the definition of a liability because providing a service is an outflow of resources embodying economic benefits.
2C	Facts as Example 2B, except that Driver and Auto can both cancel the services agreement with one month's notice. Assumption: Both sides can walk away from the agreement without financial penalty	The staff continues to think that on 1 December 2010, Auto made two promises to Driver (the same as Example 2B). On 31 December 2010 the first promise does not satisfy the definition of a liability, but the second promise is a liability. However, there is one important difference in this example. In Example 2B, Auto's first promise was to repair Driver's car if it breaks down *on or before 30 November 2011*. Auto's second promise was to provide breakdown services until *30 November 2011*. In this example both promises are for *1 month only*. This is because: • Auto is only committed to provide breakdown services to Driver for the non-cancellable period of the services agreement, • Auto can avoid his commitment to provide breakdown services to Driver for the remaining 10 months of the services agreement, and • Driver has no enforceable right to call upon Auto to provide breakdown services beyond the non-cancellable period. In other words, Auto cannot simply walk away from the status quo on the balance sheet date, but he can walk away after 1 month.
2D	Facts as Example 2B, except that on 31 December 2010 Driver notifies Auto that his car requires repair. Auto will repair Drivers' car in 2011	On 31 December 2010 Auto has a liability to repair Driver's car. A present obligation exists because: • Auto is committed to repair Driver's car as a result of the services agreement, • Auto has no realistic alternative to repairing Driver's car, and

	Example	Tentative conclusion
		• Driver has an enforceable right to call upon Auto to repair his car. In other words, Auto cannot walk away from the status quo on the balance sheet date. A liability exists because repairing Driver's car is expected to result in an outflow of resources embodying economic benefits. On the balance sheet date Auto also has a liability to provide breakdown services to Driver for another 11 months, for the reasons outlined in Example 2B
2E	Facts as Example 2B, except that on 1 December 2011 Driver (i) notifies Auto that his car requires repair, and (ii) asks Auto to renew his services agreement for another 12 months. Assumption: it is certain that Driver's car did not require repair on 30 November 2011 – no IBNR	On 1 December 2011 Auto does not have a liability to repair Driver's car because: • Auto is not committed to repair Driver's car if it breaks down after 30 November 2011, • Auto can choose not to renew Driver's services agreement (Auto's offer to waive that right expired on 31 January 2011), and • unless Auto agrees to renew his services agreement on 1 December 2011, Driver has no enforceable right to call upon Auto to either repair his car or provide breakdown services for another 12 months. In other words, Auto can walk away from the status quo on the balance sheet date
3A	Vendor sells hamburgers in a jurisdiction with no minimum food hygiene standards. But the law of that jurisdiction stipulates that if a hamburger is contaminated at the point of sale, the supplier of that hamburger must pay compensation of £100,000 to the customer. On 31 December 200X hamburgers are available for sale, but no hamburgers have been sold.	On the balance sheet date Vendor does not have a liability because he has not sold any hamburgers. As a result: • Vendor is not committed to paying compensation because there is no possibility that a contaminated hamburger has been sold, and • no customer has an enforceable right to call upon Vendor to pay compensation. Based on the facts outlined in this example, it is highly likely that Vendor will sell hamburgers *in the future*. Some of those hamburgers may be contaminated at the point of sale. However, a present *intention* to sell hamburgers (and therefore potentially pay compensation for future contaminated hamburgers sold) is not the same as a present *obligation* to pay compensation as a result of a contaminated hamburger that has already been

	Example	Tentative conclusion
		sold. Vendor can choose not to sell hamburgers and no customer has an enforceable right to call upon Vendor to sell hamburgers in the future. In other words, Vendor can simply walk away from the status quo on the balance sheet date. The staff thinks that this conclusion is consistent with Examples 1A(i) and 1A(ii) and 1B (an ability to mine in a jurisdiction subject to environmental rehabilitation laws is not a liability, and a future intention to mine is not a liability)
3C	Facts as Example 3A, except that on 31 December 200X Vendor has sold one hamburger to Customer. It is certain that the hamburger sold was contaminated at the point of sale. Vendor has not yet paid compensation to Customer	On the balance sheet date Vendor has a liability to pay compensation to Customer. A present obligation exists because: • Vendor is committed to paying Customer compensation as a result of the law, • Vendor has no realistic alternative to paying compensation because a contaminated hamburger has already been sold, and • Customer has an enforceable right to call upon the Vendor to pay compensation. In other words, Vendor can no longer walk away from the status quo on the balance sheet date. A liability exists because paying compensation is an outflow of resources embodying economic benefits
3D	Facts as Example 3A, except that there is no law. However, the food industry itself encourages a minimum level of food hygiene standards by operating a voluntary accreditation system for industry participants. Vendor wishes to participate in this system. On 31 December 200X Vendor's current food hygiene standards do not meet the minimum level required to receive industry accreditation. It aspires to do so in 200Y and expects that it will cost an additional £500,000 to meet the necessary standards	On the balance sheet date Vendor does not have a liability because participating in the industry accreditation system is voluntary. As a result: • Vendor is not committed to meeting the minimum level of food hygiene standards, • Vendor can avoid spending the £500,000 required to meet the minimum level of food hygiene standards, and • no external party has an enforceable right to call upon Vendor to meet the minimum level of food hygiene standards. Based on the facts outlined in this example, it is highly likely that Vendor will incur additional costs improving its current food hygiene standards *in the future*. However, a

	Example	Tentative conclusion
		present *intention* to incur additional costs to improve food hygiene standards in the future is not the same as a present *commitment* to incur additional costs to improve food hygiene standards. Vendor can choose not incur additional costs and no customer has an enforceable right to call upon Vendor to incur additional costs to improve its food hygiene standards in the future. In other words, Vendor can simply walk away from the status quo on the balance sheet date

APPENDIX B: CRITERIA FOR RE-EXPOSURE

B1. Paragraph 47 of the *IASB Due Process Handbook* identifies four criteria the Board should consider in assessing the need for re-exposure:

- identify substantial issues that emerged during the comment letter period on the exposure draft that the Board had not previously considered;
- assess the evidence that the Board has considered;
- evaluate whether the Board has sufficiently understood the issues and actively sought the views of constituents; and
- consider whether the various viewpoints were aired in the ED and adequately discussed and reviewed in the basis for conclusions on the ED.

B2. *Paragraph omitted from the observer notes.*

B3. *Paragraph omitted from the observer notes.*