



30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
E-mail: iasb@iasb.org Website: www.iasb.org

**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: December 2008, London

Project: Liabilities – Amendments to IAS 37

Subject: Loss of disclosure – possible obligations (Agenda paper 7)

Purpose of paper

- 1 The purpose of this paper is to help the Board decide whether to add a disclosure requirement to the revised IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. This requirement, if added, would be to disclose in the notes to the financial statements details of situations in which it is uncertain that a present obligation exists and the entity has judged that none does. Therefore the entity has not recognised a liability.
- 2 This paper discusses the three options staff see as available to the Board and proposes text for further discussion and approval by the Board.

Background

Requirements of IAS 37

- 3 At present IAS 37 identifies the term ‘contingent liability’ as:
 - a) ‘a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

- b) a present obligation that arises from past events but is not recognised because:
 - i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - ii) the amount of the obligation cannot be measured with sufficient reliability.’

4 IAS 37 prohibits entities from recognising contingent liabilities. Instead it requires entities to disclose information about them. Specifically, it requires entities to describe the nature and financial effect of the contingent liabilities and indicate the uncertainties that relate to the amount and timing of any outflow. It also requires entities to note the possibility of any reimbursement.

Exposure Draft proposals

5 The Board proposes to eliminate the term contingent liability from IAS 37 because items will either meet the definition of a liability and be covered by the requirements of the standard, or not. The Exposure Draft proposed a requirement for entities to disclose details of liabilities that are not recognised because they cannot be measured reliably (ie the second type of contingent liability, as described in paragraph 3(b)). However, the ED did not propose a requirement for entities to disclose details of ‘possible obligations’ that entities conclude do not meet the definition of a liability (the first type of contingent liability, as described in paragraph 3(a)).

6 This proposed change could therefore result in loss of information to the users of the financial statements about items the entity judged not to be liabilities at the end of the reporting period. At the time of the drafting of the ED, the Board did not think that this loss of information would be significant. The Board concluded that most items that had previously been regarded as ‘possible obligations’ would meet the definition of a liability. Although many ‘possible obligations’ appeared to be conditional on future events, they had unconditional obligations associated with them. For example:

- a) a warranty gave the entity an unconditional obligation to stand ready to fulfil claims, and
- b) a lawsuit gave the entity an unconditional obligation to stand ready to act as the court directed.

These unconditional obligations would be recognised as liabilities and details of the uncertainties disclosed. In particular, there would be no loss of information about litigation—the most common type of contingent liability disclosure.

7 The Board also took the view that ‘possible obligations’ that do not meet the definition of a liability were in most cases business risks. Such items are typically discussed in the financial reviews that accompany the financial statements. The effects of these items would also often be disclosed in accordance with the requirements in IAS 1 *Presentation of Financial Statements*. IAS 1 requires the disclosure of major sources of estimation

uncertainty that may have a significant risk of resulting in material adjustments to assets or liabilities in the next financial year.¹

Comment letters and subsequent Board discussions

- 8 At its meeting in July 2006, the Board discussed the effects of eliminating the term ‘contingent liability’. The board paper for that meeting² recommended that the Board affirm its proposal to eliminate the term ‘contingent liability’ and that any final standard should include disclosure of the factors that influenced the entity’s judgement in situations in which it is not certain whether a past event gives rise to a liability. This recommendation reflected the staff conclusion that management discussion and analysis and the IAS 1 requirements would be insufficient to ensure that important information would be disclosed.
- 9 The Board confirmed its decision to eliminate the term ‘contingent liability’. It did not reach a decision on whether to add a further disclosure requirement. It discussed the possibility of developing a disclosure principle that would allow users to evaluate an entity’s determination of whether a liability exists in cases in which there is uncertainty about that determination. The Board, however, was concerned that such a principle would be impracticable. Therefore, the Board directed the staff to explore more specific disclosure requirements, for example to capture asserted legal claims for which the entity concludes that it has no present obligation. The Board asked the staff to come back to the Board with further suggestions.
- 10 At the round-table meetings that were held in November and December 2006, almost all participants expressed concerns that eliminating the term contingent liability would reduce the amount of useful disclosure provided about items that do not satisfy the definition of a liability at the end of the reporting period. They did not consider the general requirements in paragraph 125 of IAS 1 sufficient to capture this information.

Whether to add back a disclosure requirement

Staff analysis

Business risks

- 11 As described in paragraphs 8-10 and based on comment letter analysis, there seems to be a common concern among constituents that eliminating the term ‘contingent liability’ would result in reduced disclosure about items that, at the

¹ IAS 1: paragraph 125

² Board meeting July 2006, agenda paper 4A

end of the reporting period, do not meet the definition of a liability. The staff also agrees that there may well be a gap in the disclosure requirements proposed in the ED. But we think that gap specifically relates to disclosure about situations in which the existence of a liability is uncertain but no liability is judged to exist, rather than disclosure of all potentially significant risks that the entity faces at the end of the reporting period.

Possible obligations

- 12 At its meeting in July 2006, the Board decided that, although it did not wish to add disclosure requirements for business risks, there may be a case for adding disclosure requirements for a narrower range of ‘non-liabilities’, ie for situations in which there is some evidence that the entity may have a present obligation, but having considered all available evidence, the entity has judged that it does not.

Arguments against adding back disclosure requirement

- 13 One argument against requiring disclosure about possible obligations, which has been raised in Board discussions in similar circumstances, is that if management has concluded, on the basis of all available evidence, that it does not have a present obligation, why should it then give information about a non-liability? Would we then be requiring entities to disclose information that could be used by users to ‘second guess’ management judgements?
- 14 It can also be argued that adding a disclosure requirement for non-liabilities to a standard about liabilities is inappropriate. By removing the term ‘contingent liability’ in the ED, those possible obligations that, by and large, are business risks would also be removed from the scope of the revised IAS 37. So why should the revised IAS 37 deal with these items? Should that not be done within another standard?
- 15 Another argument for not requiring a disclosure in these instances is that if there is a possibility that the entity has an obligation that could be considered to be a significant risk to the business, then there are already requirements in other standards to disclose this information. Paragraph 122 of IAS 1 states that:
- An entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations ... that management has made in the process of applying the entity’s accounting policies and that have the most significant effect on the amounts recognised in the financial statements.
- 16 It could therefore be argued that the most that would be needed in IAS 37 is a cross reference to IAS 1. The cross reference could perhaps be given at the end the guidance in IAS 37 on uncertainty about the existence of a present obligation. It could perhaps say something like:

If management judges that the entity does not have a present obligation, it may need to disclose that judgement in accordance with paragraph 122 of IAS 1 *Presentation of Financial Statements*.

Arguments for adding back a disclosure requirement

- 17 The view of constituents is that the proposed changes to IAS 37 will lead to a loss of disclosure about ‘possible’ obligations. If they are right, the loss will be greater than the Board thought when the ED was published. This is because the Board has since changed and refined its views on the range of circumstances in which there might be uncertainty over the existence of a present obligation.
- 18 In particular, the Board has changed its view on litigation. It no longer thinks that the start of legal proceedings against an entity in itself gives rise to a present obligation for the entity. Rather, the Board’s view now is that the entity has a present obligation only if it has committed the wrongful act for which it is being sued.
- 19 Whether the entity has committed such an act will often be uncertain. Since publishing the ED, the Board has spent time discussing such uncertainties and tentatively concluded that:
- a) there will be situations in which there is uncertainty about whether an event that gives rise to the obligation has occurred. (In the much debated hamburger example, the Board concluded that the event that gave rise to an obligation was the sale of a contaminated hamburger, not the sale of a hamburger that *might* be contaminated. In the absence of proof that the entity had or had not sold a contaminated hamburger, there would be uncertainty about whether the obligating event had occurred.)
 - b) in a situation in which it is uncertain whether an obligating event has occurred, the assessment of whether a liability exists would be a matter of judgement, taken on the basis of all the available evidence. (No probability threshold, such as ‘more likely than not’, should be used in the standard.)
 - c) The relevant evidence could include:
 - i) past experience;
 - ii) claims made against the entity;
 - iii) opinions of experts; and
 - iv) information provided by events occurring after the reporting period.
- 20 Applying this guidance, entities might conclude that they do not have a present obligation. Most, if not all, lawsuits are contested and early in the proceedings there may be insufficient evidence of wrongdoing to justify the conclusion that the entity has an obligation. Therefore, an entity that is subject to litigation might not recognise a liability. And as a consequence of this, in the absence of

further disclosure requirements, there could be loss of information about litigation—the most common type of contingent liability disclosure at present.

- 21 It could be argued that a requirement to disclose information about all situations of uncertainty is unduly onerous and open ended. However, the Board could address this concern by limiting further the circumstances in which the disclosure is required. Specifically, the Board could:
- a) specify in positive terms a population of items for which disclosure would be required. (How the Board might identify such a population is discussed below.)
 - b) consistent with the existing requirements of IAS 37 for contingent liabilities, not require disclosure if the possibility of there being a liability is remote.
 - c) make the disclosure requirement subject to the same ‘prejudicial information’ exemption as disclosures for recognised liabilities. In other words, information would not have to be disclosed if and to the extent that disclosure would be expected to prejudice seriously the position of the entity in a dispute with other parties.
- 22 It should also be noted that it is not the purpose of this paper to address other issues specific to litigation, such as the extent to which the prejudicial information exemption will apply. That and other issues relating to litigation will be discussed with the Board at a future meeting.

Defining the population of items requiring disclosure

- 23 A requirement to disclose items that are judged not to be liabilities is rather open-ended. This is because the population of items is defined in negative terms and may cause the limits of disclosure requirement to be unclear. A way of solving this could be by seeking to define the population of items in positive terms.
- 24 One way of defining the population in positive terms would be to require disclosure only when specific indicators are present. For example, the disclosure requirement could be limited to circumstances in which there is evidence in some form of legal proceedings involving the entity, the outcome of which could have a material effect on it.
- 25 This ‘indicator’ type of approach has been adopted in IAS 27 *Consolidated and Separate Financial Statements*. Paragraph 41(b) of IAS 27 requires entities to explain why they have judged that they do not control (and hence have not consolidated) any investee in which they own more than half of the voting power or potential voting power.
- 26 If this type of approach is used, the Board will have to identify the indicators that should be used to filter out the situations requiring disclosure.

Possible indicators

- 27 The most common situation where there is uncertainty about the existence of a material present obligation is litigation. Therefore legal proceedings are probably the situations users of financial statements would be most interested in. It might be sufficient to use the commencement of legal proceedings against an entity as the indicator that triggers the need for disclosure.
- 28 Some regulatory bodies require disclosure of litigation as part of the documentation that companies need to file with them. For example:
- a) the US Securities and Exchange Commission (SEC) requires, as a part of its regulation S-K, registrants to disclose in Form 10-K³ information about legal proceedings. The requirements are set out in full in the appendix to this paper. Under item 103 registrants have to disclose information about any material pending legal proceedings they are involved in and similar information about any other proceedings that are known to be contemplated by governmental authorities against them.
 - b) a requirement to disclose information of this nature can also be found in European Commission (EC) regulation 809/2004 on information to be contained in prospectuses. The regulation requires entities to disclose:

Information on any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the issuer is aware), during a period covering at least the previous 12 months which may have, or have had in the recent past, significant effects on the issuer and/or group's financial position or profitability, or provide an appropriate negative statement.
- 29 If this kind of approach were adopted it would not cover all situations in which it is possible but not certain that an obligation exists. It would address only three types of situations in which there is uncertainty about the existence of an obligation, namely litigation, arbitration and pending actions by governmental/regulatory authorities. However it could be argued that these situations are probably the most common and those that interest users the most. An alternative approach that would capture every possible obligation is likely to be unduly open-ended and hence onerous to apply in practice.
- 30 There may be other possible obligations of interest to users that will not be picked up by the proposed disclosure requirement. Examples of such situations could include possible illegal acts and environmental issues that have not been detected and, hence, have not yet triggered legal proceedings. However, although in theory these situations should be disclosed, it is unlikely that entities would disclose them, if undetected by either public or the authorities, even if required to disclose *all* possible obligations. By disclosing such information entities would be admitting to some wrongdoing and could as a consequence face some legal action over it.

³ Form 10-K is used by SEC registrants when filing annual financial statements with the SEC

- 31 An alternative way of defining the population for which disclosures would be required could be to use indicator such as ‘claims lodged against the entity’. When the Board last discussed this in July 2006 that kind of approach was suggested.
- 32 Using ‘claims’ as the indicator, the disclosure requirement could potentially capture a wider range of possible obligations than just litigation and possible or pending governmental/regulatory actions. However, it would probably be necessary to clarify exactly what was meant by claim. It would also be necessary to exclude those claims that arise in the normal course of business (such as claims from customers for discounts) and are addressed within the scope of other standards. It is also possible that ‘claim’ would not capture some legal or regulatory proceedings at an early stage, as they might be well advanced before any claim against the entity is formally made. These legal or regulatory proceedings would be of interest to users before that stage.
- 33 If disclosure is to be required, then the Board also has to decide at what point the entity has to disclose information about these situations. The staff thinks that it would be appropriate for an entity to disclose information about these situation in the first reporting period in which it becomes involved in legal, governmental or arbitration proceedings or becomes aware that any such proceedings are pending or threatened.

Staff conclusions and recommendations

- 34 The staff has indentified three options:
- a) to keep the disclosure requirements proposed in the exposure draft, ie not adding any new disclosure requirement;
 - b) to add into the standard a cross reference to paragraph 122 of IAS 1 in order to highlight the need to disclose judgements that have the most significant effects on the financial statements (using wording such as that proposed in paragraph 16 above);
 - c) to add a disclosure requirement.
- 35 The staff believe that the arguments for adding the disclosure in paragraph 17-22 outweigh the arguments in paragraphs 13-16 for not doing so. There seems to be a real possibility that if a disclosure requirement is not added to the standard that important information would not be disclosed to users.
- 36 Based on this analysis, the staff recommends option (c) in paragraph 34, ie to add a disclosure requirement to the revised standard.
- 37 This disclosure requirement should in the staff’s opinion be based on an indicator approach as described in paragraphs 23-26—otherwise the requirement could become too open ended. The staff also think that the wording in EU prospectus regulation (paragraph 28(b) above) would be well suited to describe the indicators for disclosure, more so perhaps than the

wording used in the SEC requirement. It captures quite succinctly a wide range of possible obligations.

Questions for the Board

- 38 Do you agree that a disclosure requirement should be added to the standard (option (c) in paragraph 34)?
- 39 Do you agree that disclosure should be required only if specific indicators that the entity might have a liability are present?
- 40 Do you agree that the specified indicator should be similar to that used by the EU for prospectus disclosures, ie governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the issuer is aware),?

Information to be disclosed

- 41 If the Board decides to add a requirement to disclose details of situations in which there is an indication that the entity might have a liability but no liability has been judged to exist, it must also decide what information should be disclosed.

Staff analysis

- 42 The staff is not recommending the same sort of disclosure requirements that were put forward in FASB's proposed amended FAS 5 *Disclosure of Certain Loss Contingencies*. In its Exposure Draft the FASB proposed a disclosure requirement for all loss contingencies, regardless of the likelihood of loss, in the circumstances when:
- a) the contingency is expected to be resolved in the near term (period not exceeding one year) and
 - b) it could have severe impact on the entity's financial position, cash flows or result of operation.
- 43 Rather, the objective of adding a disclosure requirement would be to avoid loss of disclosure when IAS 37 is revised. To be consistent with this objective, the information required to be disclosed would be similar to that currently required to be disclosed for contingent liabilities by IAS 37.
- 44 At present, paragraph 86 of IAS 37 states that:
- Unless the possibility of any outflow in settlement is remote, an entity shall disclose for each class of contingent liability at the end of

the reporting period a brief description of the nature of the contingent liability and, where practicable:

- a) an estimate of its financial effect, measured under paragraphs 36–52;
- b) an indication of the uncertainties relating to the amount or timing of any outflow; and
- c) the possibility of any reimbursement.

45 This requirement has been brought into the ED for liabilities that are not recognised because they cannot be measured reliably. Paragraph 69 of the ED states that:

If a non-financial liability is not recognised because it cannot be measured reliably, an entity shall disclose that fact together with:

- a) a description of the nature of the obligation;
- b) an explanation of why it cannot be measured reliably;
- c) an indication of the uncertainties relating to the amount or timing of any outflow of economic benefits; and
- d) the existence of any right to reimbursement.

46 The staff note that any more extensive disclosure requirements would exceed those currently required for contingent liabilities and those proposed for liabilities that are recognised. Therefore, inclusion of any further disclosure requirements would require the Board to consider re-exposing the proposals.

Staff conclusions and recommendations

47 In light of the analysis above, the staff recommends the following wording for a requirement to disclose legal proceedings for which no liability has been judged to exist:

If an entity:

- (a) is the subject of any governmental, legal or arbitration proceedings that could have a material effect on the entity's financial statements in future periods; but
- (b) has judged that no liability exists in respect of those proceedings,

the entity shall disclose, unless the possibility of there being a liability is remote:

- i) a description of the proceedings

- ii) an indication of the uncertainties relating to the amount or timing of any possible outflows of economic benefits; and
- iii) the existence of any right to reimbursement

This disclosure requirement would be subject to same the prejudicial exemption as the disclosure requirements for recognised and unrecognised liabilities.

Question for the Board

48 Do you agree with the wording proposed in paragraph 47?

Appendix

NONFINANCIAL STATEMENT DISCLOSURES REGULATION S-K

[SEC 6900](#)

General - 300 Series

Next
[400 - 500 Series](#)

STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934, AND ENERGY POLICY AND CONSERVATION ACT OF 1975

◀Item▶ **◀103▶** Legal Proceedings.

Describe briefly any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the registrant or any of its subsidiaries is a party or of which any of their property is the subject. Include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought. Include similar information as to any such proceedings known to be contemplated by governmental authorities.

Instructions to **◀Item▶** **◀103▶**.

1. If the business ordinarily results in actions for negligence or other claims, no such action or claim need be described unless it departs from the normal kind of such actions.
2. No information need be given with respect to any proceeding that involves primarily a claim for damages if the amount involved, exclusive of interest and costs, does not exceed 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis. However, if any proceeding presents in large degree the same legal and factual issues as other proceedings pending or known to be contemplated, the amount involved in such proceedings shall be included in computing such percentage.
3. Notwithstanding Instructions 1 and 2, any material bankruptcy, receivership, or similar proceeding with respect to the registrant or any of its significant subsidiaries shall be described.
4. Any material proceedings to which any director, officer or affiliate of the registrant, any owner of record or beneficially of more than 5 percent of any class of voting securities of the registrant, or any associate of any such director, officer, affiliate of the registrant, or security holder is a party adverse to the registrant or any of its subsidiaries or has a material interest adverse to the registrant or any of its subsidiaries also shall be described.

5. Notwithstanding the foregoing, an administrative or judicial proceeding (including, for purposes of A and B of this Instruction, proceedings which present in large degree the same issues) arising under any Federal, State or local provisions that have been enacted or adopted regulating the discharge of materials into the environment or primarily for the purpose of protecting the environment shall not be deemed "ordinary routine litigation incidental to the business" and shall be described if: A. Such proceeding is material to the business or financial condition of the registrant; B. Such proceeding involves primarily a claim for damages, or involves potential monetary sanctions, capital expenditures, deferred charges or charges to income and the amount involved, exclusive of interest and costs, exceeds 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis; or C. A governmental authority is a party to such proceeding and such proceeding involves potential monetary sanctions, unless the registrant reasonably believes that such proceeding will result in no monetary sanctions, or in monetary sanctions, exclusive of interest and costs, of less than \$100,000; provided, however, that such proceedings which are similar in nature may be grouped and described generically.