



Project	Liabilities – Amendments to IAS 37
Topic	Disclosure of possible obligations

Purpose of paper

1. The purpose of this paper is to help the Board decide the circumstances in which an entity should disclose information about ‘possible obligations’ and what information should be disclosed in the revised IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.
2. The term ‘possible obligation’ refers in this paper to a situation in which it is uncertain whether a present obligation exists, but the entity has judged that none does and, therefore, has not recognised a liability.

Staff recommendation

3. The staff recommend adding a requirement to disclose the following information about all possible obligations, unless the possibility of an outflow of economic resources is remote:
 - (a) a description of the circumstances;
 - (b) estimate of the financial effect of the possible obligation;
 - (c) an indication of uncertainties relating to the amounts or timing of any outflow of economic benefits; and
 - (d) the possibility of any reimbursement.

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

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Background

Previous Board discussions

4. In July 2006, the Board considered whether to add to the revised IAS 37 a requirement to disclose possible obligations. 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 the circumstances in which such disclosures would be required were too open-ended. 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.
5. In December 2008 the Board again discussed this subject and considered proposed wording for that requirement¹. The staff recommended that disclosure should be required only if specific indicators that the entity might have a liability were present. These indicators were governmental, legal or arbitration proceedings that could have a material effect on the entity's financial statements in future periods.
6. The Board decided tentatively that the revised IAS 37 should require entities to disclose information about possible obligations. However, the Board did not agree with the indicator approach. Board members also had reservations about how well this approach would work when dealing with frivolous lawsuits.

When should disclosure be required?

7. Paragraphs 8-13 consider how to describe in general the circumstances in which disclosure of possible obligations is required. Paragraphs 14-22 then consider

¹ Board meeting December 2008, agenda paper 7.

whether any exceptions should be specified, eg if the possibility of any outflow of economic benefits is remote.

Staff analysis

8. The intention of the Board is to require disclosure of circumstances in which there is uncertainty about whether an obligation exists but the entity has judged that none does exist and hence has not recognised a liability.
9. If the Board were only to add a disclosure requirement, this disclosure requirement could be cumbersome to draft and difficult to interpret.
10. It is also very likely that a requirement to disclose items that are judged not to be liabilities will be 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.
11. The staff think that we would help clarify when the disclosure requirement would apply by:
 - (a) cross referring from the disclosure requirement back to the discussion of uncertainty in the recognition section of the standard; and
 - (b) in that section, citing litigation proceedings as examples of situations that would involve uncertainty.
12. The staff therefore think that the requirement could be drafted in the following manner. The text on identifying liabilities is based on decisions reached by the Board in July 2007. The revisions proposed to add wording are underlined.

Proposed text for recognition section of standard

In some circumstances, for example if governmental, legal or arbitration proceedings are in progress, pending or threatened against the entity, there might be significant uncertainty about whether the entity has an obligation. Such circumstances could arise if:

- (a) the facts are uncertain; or
- (b) it is uncertain how the law applies to the facts.

In such circumstances, management needs to reach a judgement about whether the entity has an obligation. It does so by considering all available evidence, which might include:

- (a) the entity's own (or other entities') past experience of similar items;
- (b) claims made against the entity;
- (c) opinions of experts; and
- (d) information provided by events occurring after the reporting period about circumstances existing at the end of the reporting period.

If management judges that, on the basis of the available evidence, the entity has an obligation, it applies the recognition criteria in paragraph x. Otherwise, the entity discloses details of a possible obligation in accordance with paragraph x.

Proposed text for disclosures section of standard

If, in situations of uncertainty described in paragraph y, an entity has judged that it does not have a present obligation it shall disclose [details discussed later in this paper]²

13. The staff have some lingering concerns about the general nature of the disclosure requirement proposed above. We still think that there would be benefits in following an indicator approach, ie to require entities to disclose information about governmental, legal or arbitration proceedings in progress, pending or threatened against the entity. The staff think that:

² The wording of the disclosure requirement is discussed later in the paper.

- (a) the situations requiring disclosure would be easier to identify. Therefore the disclosure requirement would be clearer and more straightforward to apply in practice, and
- (b) there would be no significant loss of disclosure. The staff have not identified any possible obligations that entities disclose at present, other than those relating to governmental, legal or arbitration proceedings. When constituents raised concerns about the absence of a disclosure requirement, they were concerned specifically about loss of disclosure about legal proceedings.

Questions for the Board

The staff recommend that a general requirement to disclose possible obligations should be drafted in the manner set out in paragraph 12.

1 Do you still think the Board should require disclosure of all possible obligations, rather than just governmental, legal or arbitration proceedings?

2 If so, do you agree with the wording proposed in paragraph 12?

Immaterial items and frivolous lawsuits

Staff analysis

- 14. In December 2008, Board members pointed out a problem with requiring entities to disclose these ‘possible obligations’. They feared that unless some threshold for disclosure is set, the requirement might result in disclosure of immaterial items and frivolous lawsuits. The remaining problem is therefore to find a way to filter those items that should not require disclosure.

Immaterial items

15. We could rule out disclosure of immaterial items by adding an explicit materiality threshold to the disclosure requirement. However, because materiality applies to everything in IFRSs, using a materiality threshold in this particular case could cause confusion and would be inconsistent with what the Board has done in other projects. For example, in IFRS 8 *Operating Segments* the Board did not use materiality as an explicit threshold when identifying reportable segments³. The Board did this because it was concerned that there might be uncertainty about the meaning of materiality in relation to disclosure.
16. Another option would be to use 'significant' as a threshold. The Board has done this for example in the *Fair Value Measurement* exposure draft when dealing with disclosures of transfers between levels within the fair value hierarchy⁴. The staff think however that there might be similar problems using significant as there would be using materiality when dealing with disclosure.
17. A third option would be to add a remoteness test to the requirement. Currently in IAS 37 there is a remoteness test for contingent liabilities⁵. In other words, disclosures about contingent liabilities are not required if the possibility of any outflow in settlement is remote. Adding such a test to the disclosure requirement would seem logical and is consistent with the current requirements of IAS 37.
18. The problem with using a remoteness test is that it might be considered to give management an easy way to avoid disclosure. It can be argued that in many cases the initial position of management would be that the possibility of outflow in settlement is remote. It has even been argued that disclosures of contingent liabilities are currently rather limited for this reason.

³ IFRS 8 Basis for conclusion paragraphs 28-29

⁴ *Fair Value Measurement* ,exposure draft paragraph 57 (c).

⁵ IAS7 37 paragraph 86.

19. On the other hand it can be argued that the main reason for adding disclosure about possible obligations is to prevent loss of disclosure already required by IAS 37, not to add to the requirements.

Frivolous lawsuits

20. In December 2008 one of the Board's main concerns was how frivolous lawsuits would be handled. Board members feared that the proposed disclosure would require entities to disclose information about all legal proceedings affecting them, regardless of whether they have any merit.
21. The staff acknowledges that this might be the case but thinks that it should be sufficient to apply the same method to filter out frivolous lawsuits that should not require disclosure as would be used to prevent the disclosure of immaterial items. If a lawsuit is considered to be frivolous it is considered immaterial or the outflow in settlement may be judged to be remote.
22. The staff observes that applying some kind of threshold would not rule out disclosure of frivolous lawsuit. There will undoubtedly be cases that would not be regarded as immaterial and therefore be disclosed. However the staff believe that those instances could be disclosed in such a manner that it should be relatively easy for user to understand the nature of the claim and likelihood of outflow of economic benefits in settlement.

Staff conclusions and recommendation

Staff recommendation and question for the Board

Based on the arguments in paragraphs 15-22, the staff recommend that disclosure should not be required if the possibility of an outflow of economic benefits is remote. Do you agree?

Wording of the disclosure requirement

Staff analysis

23. Finally, the Board must decide on the information that entities should be required to disclose about possible obligations. This was not discussed much in December 2008. However, Board members decided that the disclosure should include amounts involved.
24. As stated before, the Board's main objective when it decided to insert this disclosure requirement was to prevent loss of disclosure. Therefore it is logical that the new disclosure requirement should give similar information about the disclosed items that is given about contingent liabilities under current IAS 37. The information that entities are required to disclose about contingent liabilities today is in paragraph 86 of IAS 37, which is included in the Appendix and consists of the following:
- (a) a description of its nature and, if practicable, an estimate of its financial effect;
 - (b) indication of the uncertainties relating to the amount or timing of any outflow; and
 - (c) the possibility of any reimbursement.
25. Therefore the requirements listed above along with the decision of the Board to include amounts could be the basis for the wording of the new disclosure requirement.

Staff conclusions and recommendations

26. Based on the above the staff recommend using the current disclosure requirements for contingent liabilities as a basis for a disclosure requirement along the following lines:

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If, in situations of uncertainty described in paragraph y, an entity has judged that it does not have a present obligation it shall disclose, unless the possibility of outflow of economic benefits in settlement is remote, the following;

- a) a description of the circumstances;
- b) an estimate of the financial effect;
- c) an indication of uncertainties relating to the amounts or timing of any outflow of economic benefits; and
- d) the possibility of any reimbursement.

Staff recommendation and question for the Board

The staff recommend adding the disclosure requirement in paragraph 26 to the revised IAS 37. Do you agree?

Appendix

Paragraph 86 from IAS 37

86 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.