IASB Meeting | Agenda reference **11B**

Staff Paper | Date **November 2009**

Project	**Liabilities—amendments to IAS 37**
Topic	**Measurement guidance—wording refinements**

Purpose of meeting

1. In September, the Board tentatively approved measurement guidance for the standard that will replace IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

2. Subsequent conversations indicate that the wording is not as clear as it could be and, as a result, people are struggling to understand the proposed requirements. The staff think that the proposals are not inherently complicated, so we ought to be able to express them in an understandable way.

3. The purpose of the meeting is to approve a drafting change that will make the proposed requirements clearer.

The issue

4. The Board has decided tentatively that the amount that an entity would rationally pay at the end of the reporting period to be relieved of an obligation is the lowest of:

   (a) the value the entity would gain if it did not have to fulfil the obligation;

   (b) the amount the entity would have to pay to cancel the obligation; and

   (c) the amount the entity would have to pay to transfer the obligation to a third party.

5. Several people have indicated that the phrase ‘the value the entity would gain if it did not have to fulfil the obligation’ is unclear.

6. The staff agree that the phrase is not ideal:

   (a) its meaning is not immediately obvious;

   (b) its structure is awkward. It is phrased in a negative way—it refers to *not* fulfilling an obligation, when the entity actually has to fulfil it; and

   (c) it is arguably also inaccurate—arguably the value the entity would gain could depend on transfer and cancellation prices.

The intended meaning

7. When the staff explain the phrase to people, we say that it is intended to mean:

   (a) the amount by which the entity would be 'better off' today if it did not have to fulfil the obligation in future; or in other words,

   (b) the present burden of fulfilling the obligation in future; or in other words,

   (c) the measure of a liability that is the mirror of the 'value in use' measure in IAS 36 *Impairment of Assets*.

8. We also explain that we have avoided referring to the 'cost' of fulfilling the obligation because the word cost could imply that the resources expected to be sacrificed should be measured at cost (the Board proposes that they should be measured at value) and preclude the addition of a risk adjustment.

Alternative phrases

9. Taking into account the intended meaning and the need to avoid an awkward negative structure, the staff have considered three possible alternatives to 'the value the entity would gain if it did not have to fulfil the obligation'.

10. These are:

    (1) 'the economic cost of fulfilling the obligation';

    (2) 'the present burden of fulfilling the obligation'; and

    (3) 'the present value of the future outflows expected to be required to fulfil the obligation'.

(1) Economic cost of fulfilling the obligation

11. We considered using ‘economic cost’ as a term that would encapsulate a fulfillment cost notion, but allow the resources used to fulfil the obligation to be measured at their value rather than their cost.

12. However, the term ‘economic cost’ is often used in a different sense. It is used as another term for opportunity cost (the highest valued alternative forgone in pursuit of an activity), which could take into account transfer and cancellation prices.

(2) Present burden of fulfilling the obligation

13. A second option would be to refer to ‘the present burden of fulfilling the obligation’. It is a short direct phrase. The word ‘burden’ encapsulates not just the expected outflows, but also any impact of risk. It does not preclude the possibility (and perhaps even implies) that the outflows are measured at value rather than cost. And ‘burden’ is the best antonym we could find for ‘value’ (ie, in its sense of ‘worth’)—so ‘burden of fulfilling’ is readily explained as the mirror image of ‘value in use’.

14. Board members expressed dislike for the word ‘burden’ when the conceptual framework project team proposed to use it in the definition a liability. But in that context, the word was used differently—it was used to define a liability, not to quantify the measurement of the liability. (Defining a liability as a ‘burden’ is like defining an asset as a ‘value’.)

(3) Present value of future outflows required to fulfil the obligation

15. A third option would be to describe the measure more fully, using the definition of 'value in use'[1] but adapting it to apply to outflows:

> 'the present value of the future ~~cash flows~~ outflows expected to be ~~derived from an asset or cash-generating unit~~ required to fulfil the obligation'.

16. By describing the measure in this way, the Board would avoid the need for a label (such as burden) and emphasise the symmetry between the proposed measure and value in use.

17. Some might interpret 'the present value of the expected future outflows' as excluding any form of risk adjustment. However, the Board could clarify that the measure would take account of risk, as it has done in IAS 36 for value in use.

Staff conclusions and recommendation

18. The staff think that either of Options 2 or 3 would improve the wording. In other words, either:

    (a) 'the present burden of fulfilling the obligation' (Option 2); or

    (b) 'the present value of the future outflows expected to be required to fulfil the obligation' (Option 3);

    would be clearer than 'the value the entity would gain if it did not have to fulfil the obligation'.

[1] IAS 36 *Impairment*, paragraph 5.

19. Option 2 is more concise. And we think it conveys most clearly and accurately the overriding measurement objective, including the notion that the outflows are measured on the basis of their value, rather than their cost.

20. On the other hand, Option 3 uses more familiar terminology and emphasises the symmetry between the proposed measurement requirements for liabilities and existing measurement requirements for impaired assets. Therefore, it might be more readily understood by our constituents.

21. On balance, the staff prefer Option 2.

Question for the Board

Previously, the Board has decided tentatively that the amount that an entity would rationally pay at the end of the reporting period to be relieved of an obligation is the lowest of:

(a) the value the entity would gain if it did not have to fulfil the obligation;

(b) the amount the entity would have to pay to cancel the obligation; and

(c) the amount the entity would have to pay to transfer the obligation to a third party.

The staff recommend that the Board refine the wording of this guidance, replacing phrase (a) with ‘the present burden of fulfilling the obligation’ (Option 2).

Do you agree?