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Project	<b>Liabilities—amendments to IAS 37</b>
Topic	<b>Exposure of revised proposals</b>

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## Paper overview

1. In June 2005, the Board published an exposure draft of proposed amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Since February 2006, the Board has been discussing comments received and has decided tentatively to revise several aspects of the proposals.
2. The Board has now largely completed its discussions. The purpose of this meeting is to decide whether and how the Board should expose its revised proposals for further comment.
3. In this paper, the staff:
  - (a) remind the Board of the criteria for re-exposure in the IASB *Due Process Handbook* (paragraph 4);
  - (b) summarise the changes that the Board has made to the exposure draft proposals (paragraphs 5-10);
  - (c) highlight other factors that might affect the decision on whether and how the revised proposals should be exposed (paragraphs 11-15);

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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.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

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- (d) comment on some of the relevant factors (paragraph 16);
- (e) propose three options for the Board (paragraphs 17 and 18). These are:
  - (i) to issue the revised standard without formal re-exposure
  - (ii) to re-expose selected changes to the proposals, or
  - (iii) to re-expose the entire standard;
- (f) ask the Board:
  - (i) to approve one of the options; and
  - (ii) if it decides to re-expose selected changes, to approve the scope of, and procedures to be undertaken in, the limited-scope re-exposure exercise.

### Criteria for re-exposure

4. The IASB *Due Process Handbook* states that:

- 46 After resolving issues arising from the exposure draft, the IASB considers whether it should expose its revised proposals for public comment, for example by publishing a second exposure draft.
- 47 In considering the need for re-exposure, the IASB
  - identifies substantial issues that emerged during the comment period on the exposure draft that it had not previously considered
  - assesses the evidence that it has considered
  - evaluates whether it has sufficiently understood the issues and actively sought the views of constituents
  - considers whether the various viewpoints were aired in the exposure draft and adequately discussed and reviewed in the basis for conclusions on the exposure draft.
- 48 The IASB's decision on whether to publish its revised proposals for another round of comment is made in an IASB meeting. If the IASB decides that re-exposure is necessary, the due process to be followed is the same as for the first exposure draft.

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### Decisions taken since the exposure draft was published

5. An appendix to this paper (posted separately) lists the decisions that the Board has reached in the light of comments on the exposure draft. References in this paper are to the decision numbers in the appendix.
  
6. The Board has not substantially altered the main proposals in the exposure draft. The Board has affirmed the exposure draft proposals to:
  - (a) include within the scope of the standard all liabilities not within the scope of any other standard (1.2);
  - (b) eliminate the notion of a ‘contingent liability’ (2.1);
  - (c) identify liabilities as arising from unconditional obligations (2.3);
  - (d) delete the ‘probability’ recognition criterion (3.1);
  - (e) interpret IAS 37 as requiring liabilities to be measured at a current, rather than ultimate, settlement amount (4.2);
  - (f) revise the requirements for restructuring costs and onerous contracts to make them more consistent with US GAAP (7.1 and 7.2); and
  - (g) leave unchanged other existing requirements and guidance in IAS 37 (3.2, 3.3, 4.4, 5.1).
  
7. Two of the changes that the Board proposes to make to the exposure draft proposals affect only the layout of the standard. They do not change the requirements, or significantly affect or the way in which the requirements are expressed. These are the proposals to:
  - (a) format the new standard as an IFRS, rather than an amended IAS 37 (1.1)
  - (b) move application guidance from various sections of the exposure draft to an appendix. (4.3)

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8. Most of the other changes that the Board has made have been made in response to suggestions by respondents. These include:
- (a) giving more guidance on:
    - (i) distinguishing a (stand-ready) liability from a business risk (2.4 and 2.5);
    - (ii) identifying whether a present obligation exists in situations of uncertainty (2.6);
    - (iii) implementing expected cash flow techniques to measure liabilities (4.3); and
    - (iv) measuring reimbursement rights (5.2).
  - (b) reversing the conclusion that the start of legal proceedings gives rise to a liability (to stand ready to act as the court directs) (2.8).
  - (c) tightening the wording around constructive obligations (2.3 and 2.7).
  - (d) retaining disclosure requirements for restructuring activities and ‘possible obligations’ (6.1 and 6.2).
9. However, a few changes relate to issues that were not aired in the exposure draft. The most substantial of these is additional guidance interpreting the proposed measurement requirement. The Board decided to clarify the measurement requirement in response to requests from respondents. However, the additional guidance that the Board has developed (4.1) is based on only one possible interpretation of the requirement. It is a different interpretation from that widely applied in practice at present. The Board did not discuss this interpretation, or alternative interpretations, in the exposure draft.

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10. The other changes that the Board did not air in the exposure draft are less substantial. They include:
- (a) removing the ‘asset cap’ from the measurement requirements for reimbursement rights. (5.3)
  - (b) as a consequence, changing the requirements for rights to reimbursement in *IFRIC 5 Rights to Interests arising from Decommissioning, Restoration and Environmental Funds*. (9.1)
  - (c) various other minor amendments to *IFRIC 5* and *IFRS 3 Business Combinations* required for consistency with the proposed amendments to *IAS 37*. (8.1-8.5, 9.2)

### Other factors affecting decisions about re-exposure

#### *IFRIC Interpretations*

11. *IFRIC 5* and two other *IFRIC Interpretations* address liabilities within the scope of *IAS 37*. The other two *Interpretations* are:
- *IFRIC 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities*
  - *IFRIC 6 Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment*.
12. The staff think that, subject to the changes to *IFRIC 5* discussed in paragraph 10 above, the requirements of all three *Interpretations* will be consistent with the standard that replaces *IAS 37*. We hope that the Board will be able to incorporate some or all of the *Interpretations* in the revised standard, allowing them to be withdrawn. If, after considering the matter further, we think that this approach would be appropriate, we will ask for the Board’s approval at a future meeting.

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13. On this matter, it is worth noting that:
- (a) the level of detail in Interpretations is sometimes excessive for a standard, so some pruning might be desirable. The pruning process risks causing unintended changes in meaning.
  - (b) the Board did not discuss in the exposure draft the possibility of incorporating the Interpretations in the revised standard.
  - (c) paragraph 46 of the *IFRIC Due Process Handbook* states that:

The IFRIC Interpretations that would be affected by an authoritative IASB document are identified in the exposure draft of that document. The IASB informs the IFRIC when an exposure draft proposes the withdrawal of an IFRIC Interpretation.

### ***Representations from constituents***

14. Some constituents have recently discussed re-exposure with the IAS 37 project staff. All have taken the view that the Board should re-expose the entire standard, not merely selected changes. Some have argued that:
- (a) they cannot comment meaningfully on individual changes without seeing the changes in the context of the standard as a whole. The Board should at least have a working draft available on its website for respondents to access if they wish.
  - (b) some of the guidance that the Board proposes to refine in response to requests from respondents—such as guidance on distinguishing liabilities from business risks—has been refined without formal consultation with constituents. This guidance should at least be subject to a broad-based fatal flaw review.

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- (c) a long time has passed since the proposals were last exposed. Circumstances have changed since then. For example, preparers and their auditors now have experience (from applying IFRS 3) of accounting for litigation and similar liabilities without a probability recognition criterion. One auditor has told us that preparers have encountered problems. (The auditor did not provide any specific examples. No problems have been reported to the IAS 37 or IFRS 3 project staff.)

### ***Timing***

- 15. Timing issues are also relevant:
  - (a) the new standard will ideally be in place when Canada, India and Korea adopt IFRSs at the start of 2011. Many companies have transactions within the scope of IAS 37 – adopting two different standards in successive periods would increase the burden of adoption.
  - (b) most of the current Board members were involved in the development of the exposure draft and have a good understanding of how and why the proposals have developed. They are well positioned to finalise the revised standard. However, three Board members come to the end of their terms in June 2010. Thereafter, most members of the Board will have joined since the exposure draft was published. The new Board will be less well placed to finalise the revisions efficiently.

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### Staff comments

16. Having considered the factors set out above, the staff observe that:
- (a) the Board proposes only one substantial change arising from an issue that was not aired in the exposure draft. This is the proposal for clarifying the measurement requirement (see paragraph 9). Arguably, this is the only matter that individually merits consideration for further exposure.
  - (b) other changes that were not aired in the exposure draft (paragraph 10 above) are more minor. Hence, in the staff's view, they probably do not merit formal exposure in their own right. However, two of the changes—the proposals to remove the asset cap for reimbursement rights and to make a consequential amendment to IFRIC 5—could not have been anticipated by those commenting on the first exposure draft. If the Board decides to expose the proposals for clarifying the measurement requirement, it could easily invite comments on these proposals too.
  - (c) if the Board decides to incorporate IFRICs 1, 5 or 6 in the revised standard, the exposure document could also alert constituents to the proposed withdrawal of the Interpretations, and explain any proposed changes to the text of each. This step would ensure that the Board fulfils its due process responsibilities regarding the withdrawal of an IFRIC interpretation (paragraph 13(c) above).
  - (d) if the Board thinks a wide range of proposals require exposure, re-exposing the entire standard might be the most efficient method of achieving this. However, re-exposing the entire standard might not be the most efficient method of exposing the relatively narrow range of matters identified above.



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- (e) complete re-exposure would also have significant timing implications. The exposure draft would take longer to prepare and review than a limited-scope consultation document. Furthermore, even if the Board emphasised that it was seeking comments only on specific matters, some constituents are likely to treat the re-exposure as an opportunity to re-open discussions on matters (such as the removal of the probability recognition criterion) that the Board regards as resolved. Dealing with the resulting feedback would absorb even more time. It is extremely unlikely that the existing Board would be in a position to vote on the standard by June 2010. New Board members would then have to pick up the project and it is unlikely that the new Board would finalise the standard before 2011.
- (f) if the Board decided to publish a more limited-scope exposure document, it could also post on its website a complete working draft of the proposed new standard. This draft could be similar to the working draft that accompanied the limited-scope re-exposure draft of revised proposals for IAS 24 *Related Party Disclosures*<sup>1</sup>. Constituents could see the proposed measurement guidance in the context of the whole standard. They could also see, and identify any fatal flaws in, the reformatting of the standard and the wording of other proposed changes.

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<sup>1</sup> The Board published a limited-scope exposure draft *Relationships with the State: Proposed Amendments to IAS 24* in December 2008. A working draft standard, *Update on Other Amendments*, also showing other proposed amendments to the previous exposure draft, is linked to the project page [Related Party Disclosures](#) on the Board's website.

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### Options

17. In the light of these observations, the staff put forward three options for the Board to consider:

*Option 1* Issue the revised standard without formal re-exposure.

*Option 2* Undertake a limited-scope re-exposure of selected changes to the proposals:

- focusing on the proposals for clarifying the measurement guidance,
- also setting out the proposals for reimbursement rights and consequential amendments to IFRIC 5,
- explaining the proposals (if approved by the Board) to absorb IFRICs 1, 5 and 6 into the revised IAS 37, and
- accompanied by a complete working draft of the revised proposals on the Board's website.

*Option 3* Re-expose the entire standard, perhaps emphasising that the Board seeks views only on changes made since the last exposure draft.

18. The table below sets out the staff's estimates of the timescales for each option.

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Estimated timescales for the three options

Option	Process	Target date
1	Issue revised standard with no formal re-exposure.	<b>First quarter 2010</b>
2	<p>Formally re-expose proposals to clarify measurement requirement and selected other minor changes, with 3-4 month comment period.</p> <p>Place working draft IFRS on website. To be useful this would need to be 'near-final'.</p> <p>Finalise Basis for Conclusions and complete other due process procedures.</p> <p>Debate comments on proposed measurement requirements.</p> <p>Approve final standard</p> <p>Issue final standard</p>	<p>December 2009</p> <p>January 2010 – <i>Requirements &amp; guidance (including IFRICs)</i></p> <p>February 2010 – <i>Examples &amp; amendments to other standards</i></p> <p>March-April 2010</p> <p>May 2009</p> <p>June 2009</p> <p><b>Third quarter 2010</b></p>
3	<p>Re-expose entire standard with a 4-month comment period.</p> <p>Debate comments</p> <p>Issue final standard</p>	<p>First quarter 2010.</p> <p>Second half of 2010 – and possibly longer?</p> <p><b>Mid 2011?</b></p>

## Questions for the Board

### Question 1—Extent of re-exposure

Do you think that the Board should:

- 1 issue the revised standard without formal re-exposure;
- 2 undertake a limited-scope re-exposure of selected changes to the proposals; or
- 3 re-expose the entire standard?

### Question 2—Scope of, and procedures for, a limited-scope re-exposure

If the Board decides to undertake a limited-scope re-exposure, the staff recommend that the Board:

- (a) publish a limited-scope exposure document that seeks comments on proposals to:
  - (i) clarify the measurement requirement as set out in section 4.1 of the appendix to this paper;
  - (ii) delete the cap on the measurement of reimbursement rights, and make consequential amendments to IFRIC 5; and
  - (iii) incorporate IFRICs 1, 5 and/or 6 in the revised standard (if the Board approves this proposal).
- (b) post on its website as early as possible during the comment period a working draft standard that shows all the other changes to the previous exposure draft proposals.
- (c) in the published exposure document, alert constituents to the existence of the working draft standard and the nature of the other changes.

Do you agree?