Project **Agenda decision**

Topic **IAS 37 Provisions, Contingent Liabilities and Contingent Assets – analysis of comments**

Introduction

1. The IFRS Interpretations Committee received a request in October 2010, to clarify whether the discount rate used to calculate provisions should be adjusted for own credit.

2. The Committee discussed the issue at its meeting in November 2010[1] and issued a tentative agenda decision not to take the issue on to its agenda.

3. This paper discusses the comments received on the tentative agenda decision.

Comment letter analysis

4. Four comment letters were received on this tentative agenda decision. Two of the respondents[2] agreed with the decision.

5. The second respondent[3] agreed with the decision, but suggested some amendments to the wording. It requested that the agenda decision be expanded to acknowledge that the request received by the Committee assumed that future cash flow estimates were not adjusted for credit risk. The staff agrees.

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[1] Agenda paper 10 - http://www.ifrs.org/NR/rdonlyres/74758A18-D334-4EB3-8EAE-B66B76E4E74B/0/1011obs10IAS37DiscountRate.pdf

[2] Deloitte; BusinessEurope

[3] Accounting Standards Board of Canada

6. The respondent also requested that the wording be expanded to include the fact that the guidance in IAS 37 is not clear about whether the future cash flow estimates should be adjusted for own credit risk. The staff note however that the issue of adjusting future cash flows for own credit risk was not the subject of the discussion by the Committee at the November meeting. In paragraph 4 of agenda paper 10 at this meeting, the staff noted that paragraph B5 of the submission stated that 'For purposes of the rest of this discussion we assume that the future cash flow estimates have not been adjusted for any expectations regarding the entity's credit risk, so we are concerned only with an adjustment to the discount rate.'

7. The third comment letter[4] did not agree with the agenda decision. The respondent states that '[w]e understand that predominant practice today is to exclude credit risk from the measurement of provisions', and that it believes this to be 'the most appropriate approach'. The respondent is concerned that the wording of the agenda decision may cause more diversity than it is trying to prevent. However, as the staff stated in agenda paper 10 for the November meeting, there *is* reportedly divergence in practice as it seems current guidance is not clear on this issue. In addition, in September 2010, the Board acknowledged the need for more guidance on this issue to be incorporated into the new liabilities standard, as a result of the comments received on the *Liabilities* exposure draft.

8. This respondent also states that the issue should rather be clarified through an interpretation, than waiting for the Board to deal with it in its deliberations on the Liabilities project, the timing of which is 'uncertain'.

9. While the staff understands this concern about timing, it notes that issuing an Interpretation could take at least a year, by which time the Board are expected to have discussed the issue and published an exposure draft. When the staff were assessing the issue against the agenda criteria in agenda paper 10, it concluded that IAS 37 measurements in general, and discount rate requirements in

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[4] pwc

particular, are vague. Accordingly, any consensus the Committee were to reach could differ from the decisions made by the Board, as it continues its deliberations of the *Liabilities* project.

Staff recommendation

10. Following the discussion above, the staff recommends that the Committee should finalise the agenda decision, as set out in Appendix A.

Question 1 – Final agenda decision
Does Committee agree with the staff's recommendation? Does the Committee have any further comments on the wording for the agenda decision in Appendix A?

Appendix A – Agenda decision

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* – Inclusion of own credit risk in the discount rate

The Committee received a request for interpretation of the phrase 'the risks specific to the liability' and whether this means that an entity's own credit risk (performance risk) should be excluded from any adjustments made to the discount rate used to measure liabilities. The request assumes that future cash flow estimates have not been adjusted for the entity's own credit risk.

The Committee observed that paragraph 47 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* states that 'risks specific to the liability' should be taken into account in measuring the liability, but that the guidance is not clear about whether an entity's own credit risk should or should not be included in the discount rate as a 'risk specific to the liability'.

The Committee noted that this request for guidance would be best addressed as part of the Board's project to replace IAS 37 with a new liabilities standard, and that the Board is already considering the request for additional guidance to be incorporated into this new standard. Consequently the Committee [decided] not to add this issue to its agenda.

BUSINESSEUROPE

Mr. R Garnett,
Chairman IFRS Interpretations Committee
30 Cannon Street,
London EC4M 6XH

15 December 2010

Dear Mr. Garnett,

Re: Tentative agenda decision: IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* – Inclusion of own credit risk in the discount rate

During its November 2010 meeting, the IFRS Interpretations Committee (hereafter "IFRIC") discussed a request for the clarification, if either the discount rate or the estimated future cash flows used to measure a provision under IAS 37, can or should be adjusted for the entity's own credit risk.

The IFRIC commented on this in its tentative agenda decision published in the November 2010 IFRIC Update and noted that paragraph 47 of IAS 37 states that "risks specific to the liability should be taken into account in measuring the liability" and that IAS 37 would not be clear whether an entity's own credit risk should or should not be included in the discount rate as a "risk specific to the liability".

From the IFRIC Staff papers, the underlying submission attached to these papers and the IFRIC exchange of views during the November 2010 meeting we understand that some believe that, based on the discussions the IASB had in connection with the measurement of financial liabilities, it could be argued that credit risk should be considered as a risk specific to a provision.

BUSINESSEUROPE believes that credit risk is not a risk specific to a provision and that the measurement of a provision is fundamentally different to the measurement of a financial liability. We therefore strongly support view B of the IFRIC Staff paper and believe that IAS 37 is clear in this respect and should not be impacted by discussion on only distantly related issues (i.e. the measurement of financial liabilities in the scope of IAS 39 / IFRS 9) or by guidance under US GAAP.

Yours sincerely

J. Chauvin

Jérôme P. Chauvin
Director
Legal Affairs Department
Internal Market Department

APPENDIX

IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Inclusion of own credit risk in the discount rate (published in November 2010 IFRIC Update)

The Committee received a request for interpretation of the phrase 'risks specific to liability' and whether this means that an entity's own credit risk (performance risk) should be excluded from any adjustments made to the discount rate used to measure liabilities.

The Committee observed that paragraph 47 of IAS 37 Provisions, Contingent Liabilities and Contingent Assets states that 'risks specific to the liability' should be taken into account in measuring the liability, but that the guidance is not clear about whether an entity's own credit risk should or should not be included in the discount rate as a 'risk specific to the liability'.

The Committee noted that this request for guidance would be best addressed as part of the Board's project to replace IAS 37 with a new liabilities standard, and that the Board is already considering the request for additional guidance to be incorporated into this new standard. Consequently the Committee [decided] not to add this issue to its agenda.

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December 13, 2010

(by e-mail to ifric@ifrs.org)

IFRS Interpretations Committee
30 Cannon Street,
London EC4M 6XH
United Kingdom

Dear Sirs,

Re: Tentative agenda decision on IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* – Inclusion of own credit risk in the discount rate

This letter is the response of the staff of the Canadian Accounting Standards Board to the IFRS Interpretation Committee's tentative agenda decision on whether an entity's own credit risk (performance risk) should be excluded from any adjustments made to the discount rate used to measure liabilities under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.* This tentative agenda decision was published in the November 2010 IFRIC Update.

The views expressed in this letter take into account comments from individual members of the staff of the Canadian Accounting Standards Board. They do not necessarily represent the view of the Canadian Accounting Standards Board or a common view of its staff. Views of the Canadian Accounting Standards Board are developed only through due process.

We agree with the Committee's decision not to add this item to its agenda for the reasons provided in the tentative agenda decision. However, we recommend expanding the agenda decision to also apply to future cash flow estimates to reflect the assumption made in the request and the Committee's discussion. The Appendix includes suggested amendments to the tentative agenda decision.

We would be pleased to provide more detail if you require. If so, please contact Kathryn Ingram, Principal, Accounting Standards at +1 416 204-3475 (e-mail kathryn.ingram@cica.ca).

Yours truly,

Peter Martin

Peter Martin, CA
Director,
Accounting Standards

Appendix

We suggest clarifying the tentative agenda decision as follows:

IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Inclusion of own credit risk in the discount rate

The Committee received a request for interpretation of the phrase ‘the risks specific to the liability’ and whether this means that an entity’s own credit risk (performance risk) should be excluded from any adjustments made to the discount rate used to measure liabilities. The request assumes that the future cash flow estimates have not been adjusted for any expectations regarding the entity’s credit risk.

The Committee observed that paragraph 47 of IAS 37 Provisions, Contingent Liabilities and Contingent Assets states that ‘risks specific to the liability’ should be taken into account in measuring the liability.~~,~~ The Committee noted ~~but~~ that the guidance is not clear about whether an entity’s own credit risk should or should not be included in the discount rate or future cash flow estimates as a ‘risk specific to the liability’.

The Committee noted that this request for guidance would be best addressed as part of the Board’s project to replace IAS 37 with a new liabilities standard, and that the Board is already considering the request for additional guidance to be incorporated into this new standard. Consequently the Committee [decided] not to add this issue to its agenda.

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Mr Robert Garnett
Chairman
IFRS Interpretations Committee
30 Cannon Street
London
United Kingdom
EC4M 6XH

Email: ifric@iasb.org

13 December 2010

Dear Mr Garnett,

Tentative agenda decision: IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* – Inclusion of own credit risk in the discount rate

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the November 2010 IFRIC Update of the tentative decision not to take onto the IFRS Interpretations Committee's agenda a request for an Interpretation of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* with respect to 'risks specific to liability' and whether this means that an entity's own credit risk (performance risk) should be excluded from any adjustments made to the discount rate used to measure liabilities.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0)20 7007 0884.

Yours sincerely,

Veronica Poole
Global Managing Director
IFRS Technical

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IFRS Interpretations Committee
1st Floor
30 Cannon Street
London
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13 December 2010

Dear Sirs

Tentative agenda decision: IAS 37 Provisions, Contingent Liabilities and Contingent Assets - Inclusion of own credit risk in the discount rate

We are responding on behalf of PricewaterhouseCoopers to your invitation to comment on the tentative agenda decision "*IAS 37 Provisions, Contingent Liabilities and Contingent Assets - Inclusion of own credit risk in the discount rate*" ("the agenda decision") published in the November 2010 edition of IFRIC Update.

Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on the agenda decision. 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We do not agree with the decision to defer consideration of this issue until the IASB's project to replace the provisions standard, IAS 37, or with the reasons given for that decision.

We are aware of some differences of view on this issue, and we believe there may be limited diversity in practice today. We are concerned that the agenda decision might result in further diversity that does not exist today. The timing of the IASB's project to replace IAS 37 is uncertain, and it is likely that completion of this project may take some time. We are concerned that leaving this issue open on the basis of the agenda decision until the project to replace IAS 37 is completed will reduce consistency for a prolonged period, particularly among those entities adopting IFRS for the first time.

We believe that any uncertainty about the existing guidance in IAS 37, which requires that the discount rate reflects risk specific to the liability being measured, could be clarified easily and quickly through an interpretation. This would eliminate any current diversity in practice and would reduce the risk of additional diversity developing in the future.

We understand that predominant practice today is to exclude credit risk from the measurement of provisions. This is based on the argument that credit risk is specific to the entity; it is not specific to the liability. IAS 37 paragraph 43 states that 'risk describes variability of outcome'. Risk in the context of a provision reflects uncertainty about the resources that will be required to settle or fulfil the obligation, which does not include the entity's own credit risk. We support this interpretation and we believe that the most appropriate approach is for credit risk to be excluded from the discount rate used to measure a provision.

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We note the concerns expressed in the July 2009 report of the Financial Crisis Advisory Group, which recommended that 'the Boards should reconsider the appropriateness of an entity's recognition of gains or losses as a result of fair value changes in the entity's own debt because of decreases or increases, respectively, in its creditworthiness'. Including an entity's own credit risk in the measurement of a provision would result in a reduction in the liability and a gain if the entity's creditworthiness decreases, despite there being no change in the obligation. Financial information prepared on this basis would not be decision-useful. We note also that the notion that own credit risk should affect profit has been rejected in several of the Board's recent proposals, including its proposals on insurance and financial instruments and the project to replace IAS 37.

We are also concerned that an adjustment to increase the discount rate when an entity's credit worthiness decreases is counter- intuitive. A decrease in creditworthiness suggests an increased risk that the obligation will not be settled or fulfilled. This suggests that the liability should be increased to reflect this risk. It is counter- intuitive for the discount rate to be increased and the liability reduced with the recognition of income in these circumstances.

If you have any questions in relation to this letter please do not hesitate to contact John Hitchins, Global Chief Accountant (+44 20 7804 2497) or Tony de Bell on (+44 20 7213 5336).

Yours faithfully

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP