INTERNATIONAL FINANCIAL REPORTING BULLETIN 2010/14

MEASUREMENT OF LIABILITIES IN IAS 37, LIMITED RE-EXPOSURE OF PROPOSED AMENDMENTS TO IAS 37

STATUS
Exposure Draft

EFFECTIVE DATE
n/a

ACCOUNTING IMPACT
The measurement of liabilities not covered by other IFRSs

Background

In 2005 the International Accounting Standards Board (IASB) issued an exposure draft (the ED) of proposed amendments as part of its project to improve IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (IAS 37). The main objectives of the IASB's project were to:

- Align the criteria of IAS 37 for recognising a liability with those in other IFRSs. IAS 37 requires an obligation to be recognised as a liability if it is probable that the obligation will result in an outflow of cash or other resources. Other IFRSs such as IFRS 3 *Business Combinations* and IAS 39 *Financial Instruments: Recognition and Measurement*, do not apply a 'probability of outflows' criterion, instead applying fair value measurement;
- Eliminate some differences between IAS 37 and US GAAP with respect to when entities recognise costs of restructuring their businesses; and
- Clarify the measurement requirements of liabilities IAS 37 since the current requirements are vague.

The 2005 exposure draft proposed, among other things, to remove the term 'best estimate' from IAS 37 and instead focus on the other guidance in the Standard which stated that the best estimate of a liability is the amount that an entity would rationally pay to settle the liability or to transfer it to a third party at the end of the reporting period. It was proposed that this amount would be measured by taking into account all possible outcomes – not only the minimum, maximum or most likely amounts.

The ED has been issued by the IASB as some respondents to the 2005 ED thought that the proposed requirements remained unclear. For example, what did the term 'settle' mean? Did it mean cancel the obligation or fulfil the obligation? What if the amount to settle the obligation was different than the amount to transfer it – which of the two amounts should be used to measure the liability? In response to these concerns, the IASB has proposed additional guidance specifying more precisely what entities should be aiming to measure, and how to achieve those aims.

Proposals

Initial Measurement

It is proposed that a liability would be measured at the amount an entity would rationally pay at the end of a reporting period to be relieved of the present obligation.

The amount an entity would rationally pay to be relieved of an obligation would be measured as the lowest of:

(a) The present value of the resources required to fulfil the obligation, measured in accordance with Appendix B (see below);

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

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

Additional guidance proposes that if an entity is unable to cancel or transfer the obligation, or if there is no evidence that an entity can transfer of cancel the obligation for a lower amount, then the obligation would be measured at the present value of the resources required to fulfil the obligation. It is also proposed that the amount that would be paid to cancel or transfer the obligation to a third party is the price the counterparty or third party would demand, plus any cost of cancellation of transfer.

Subsequent measurement

The carrying amount of a liability at the end of each reporting period would be adjusted to the amount that the reporting entity would rationally pay to be relieved of the present obligation at that date (see above). Changes in the carrying amount of the liability due to the passage of time (ie the unwinding of discount) would be recorded as borrowing costs.

The ED also includes appendices which set out definitions of a 'liability' and an 'onerous contract' and provide additional explanatory guidance on how the present value of the resources required to fulfil an obligation (see above) should be measured. The proposals would require an entity to take into account the expected outflows of resources (including the time value of money) and the risk that the actual outflows of resources might differ from those expected.

Effective date and transition

As this is an exposure draft, there is no stated effective date. The IASB intends to incorporate the proposals in the ED with the 2005 ED when it redrafts IAS 37 as an IFRS.

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