



Memorandum

To:	AASB and FRSB members	Date:	17 March 2010
From:	Clive Brodie, Mischa Ginns and Jim Paul	Agenda Item:	B7
Subject:	Liabilities: Commenting on IASB Exposure Draft and consideration of PBE/NFP amendments to IFRS to replace IAS 37	File:	

Action

The Boards are asked to:

- Consider and confirm the key messages to be included in final comment letters on the International Accounting Standards Board (IASB) Exposure Draft *Measurement of Liabilities in IAS 37* (limited re-exposure of proposed amendment to IAS 37). Refer to attachments B7.1; B7.2 and B7.4.
- Consider whether or not amendments to the IFRS that replaces IAS 37 are required in order to facilitate the new standard being applied by Public Benefit Entities/Not-for-Profit Entities (PBE/NFP). Refer to attachments B7.3; B7.5 and B7.6.

Provided below are the following:

- Explanation of the main agenda papers and planned order of the Board meeting discussion;
- Background to the IASB's Exposure Draft; and
- A high-level summary of the similarities and differences between the FRSB's draft comment letter (attachment B7.1) and the issues paper (attachment B7.2).

Main agenda papers and planned order of the Board meeting discussion

The agenda papers for this topic include both a draft FRSB comment letter to the IASB (attachment B7.1) and a AASB issues paper setting out draft comments to the IASB (attachment B7.2). The issues paper reflects the preliminary views of the AASB (which met subsequently to the FRSB and took into account the FRSB's preliminary views) and some additional points identified by the staff. The views reflected in the issues paper are supported by the staffs of both Boards.

The Boards have slightly different operating procedures for dealing with Board comment letters in Board meetings: the AASB considers substantive issues and comments thereon but not the detailed wording of its comment letter, whilst the FRSB considers a complete draft comment letter. In view of these differences in procedure, the planned order of discussion is:

- First, consider the AASB issues paper (attachment B7.2). Staff will note differences between the preliminary views of the AASB reached after the FRSB's initial discussions of the IASB Exposure Draft—these differences are set out in the table below.
- Second, consider any additional issues in the draft FRSB comment letter (attachment B7.1) - this step should be relatively brief because all major issues should be covered in the first step above.
- Third, consider the nature of any PBE/NFP amendments to be proposed in respect of the Working Draft of an IFRS that would replace IAS 37. The staffs have not identified a likely need for any PBE/NFP amendments arising specifically from the measurement proposals in the current IASB ED.

Background

The IASB issued the Exposure Draft in January 2010. Comments are due by 12 April 2010. In quarter 3, 2010 the IASB intends to issue an International Financial Reporting Standard (IFRS) to replace IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The IASB published a working draft of this new standard on its website in February 2010 – refer to attachment B7.5. The New Zealand and Australian equivalents to IAS 37 contain PBE/NFP specific provisions. The Boards need to consider whether or not similar PBE/NFP amendments will be required in order for the new IFRS to be applied by Australian and New Zealand PBEs/NFPs.

No submissions have been received to date from Australian or New Zealand constituents.

Summary of similarities and differences between the FRSB's draft comment letter and issues raised in the AASB issues paper

The table below provides a high-level summary of similarities and differences between:

- the FRSB's draft comment letter drafted based on the FRSB's discussions at its February 2010 meeting (attachment B7.1); and
- the AASB issues paper on the IASB Exposure Draft ED/2010/1 *Measurement of Liabilities in IAS 37* (attachment B7.2). Although this paper has not yet been considered by the AASB, it incorporates AASB staff's understanding of the AASB's preliminary views.

The views of the AASB and FRSB are broadly similar. The Boards tend not to support the proposals in the Exposure Draft but thus far have different recommendations and concerns at a detailed level. At least to some degree, these differences may reflect an evolution in ideas (due to the AASB considering the IASB ED after the FRSB, and taking the FRSB's preliminary views into account) rather than conflicting views *per se*. The most noticeable difference between the Boards' preliminary views is that the AASB tentatively supports the proposed temporary exception for onerous sales and insurance contracts whereas the FRSB's preliminary view is not to support such an exception.

Questions in the IASB's Exposure Draft (attachment B7.4)	Preliminary views in the AASB issues paper (base on AASB discussion)	FRSB's preliminary views	Comparison of AASB & FRSB views
<p>Question 1 – Overall requirements</p> <p>Do you support the requirements proposed in paragraphs 36A–36F? If not, with which paragraphs do you disagree, and why?</p>	<p>The proposals represent a significant change in practice going beyond clarifying the existing measurement requirements in IAS 37</p> <p>A single measurement principle should be established for all provisions and this principle should be consistent with the measurement principle for other types of liabilities, such as financial liabilities, liabilities to customers, insurance liabilities and lease liabilities.</p> <p>Provisions should be measured at the expected cost of settlement based on the most likely mode of settlement (using contractors, internal resources or a combination of both).</p> <p>The measurement approach proposed in the Exposure Draft to be inconsistent with measurement objective.</p>	<p>The IASB should establish a principle and apply this simultaneously and consistently across all similar items.</p> <p>A liability should be measured assuming that the entity will minimise the outflow of benefits required to settle the obligation. An obligation should be measured at the expected cost of fulfilling the obligation (this may be the price payable to a contractor. However, if the entity expects to fulfil the obligation itself, this would be the cost the entity will incur to fulfil the obligation.</p> <p>The measurement approach proposed in the Exposure Draft is inconsistent with the measurement objective and is inconsistent with the objective of financial reporting.</p>	<p>The AASB and FRSB have similar views. There is a need for a consistent measurement principle.</p> <p>The Boards consider the proposed measurement requirements are inconsistent with the proposed measurement objective.</p> <p>The Boards support transaction price as a measure but only in limited circumstances.</p>

Questions in the IASB's Exposure Draft (attachment B7.4)	Preliminary views in the AASB issues paper (base on AASB discussion)	FRSB's preliminary views	Comparison of AASB & FRSB views
<p>Question 2 – Obligations fulfilled by undertaking a service</p> <p>Some obligations within the scope of IAS 37 will be fulfilled by undertaking a service at a future date. Paragraph B8 of Appendix B [of the Exposure Draft] specifies how entities should measure the future outflows required to fulfil such obligations. It proposes that the relevant outflows are the amounts that the entity would rationally pay a contractor at the future date to undertake the service on its behalf. Paragraphs BC19–BC22 of the Basis for Conclusions explain the IASB's rationale for this proposal.</p> <p>Do you support the proposal in paragraph B8? If not, why not?</p>	<p>The AASB does not support the proposals.</p> <p>In particular, the AASB does not support adding a profit margin and a risk premium to the entity's expected cost of settlement when measuring a provision. Adding these items would not be consistent with the overall measurement objective in the Exposure Draft and would not provide to users the most relevant information for decision making.</p> <p>If the IASB proceeds with its proposals the AASB considers that there is a lack of guidance regarding the calculation of the profit margin and risk adjustment (particularly in regards to own credit risk).</p>	<p>The FRSB does not support the proposals.</p> <p>In particular, the FRSB does not support the inclusion of a profit margin in the measurement of a liability. The resulting measurement would be a transaction price which is not necessarily the appropriate measure.</p> <p>More often than not liabilities are not transferable. Therefore, measuring liabilities at a value other than fulfilment value is unlikely to provide useful information to users of financial statements.</p> <p>If the IASB proceeds with the proposals, the FRSB considers that there is a lack of guidance regarding how and when a risk adjustment ought to be included in the measurement.</p>	<p>Both Boards do not support this proposal.</p> <p>In particular, both Boards do not support adding a profit margin or a risk premium.</p> <p>If the IASB proceeds with its proposals, both Boards consider that there is a need for additional guidance regarding the calculation of margins.</p>

Questions in the IASB's Exposure Draft (attachment B7.4)	Preliminary views in the AASB issues paper (base on AASB discussion)	FRSB's preliminary views	Comparison of AASB & FRSB views
<p>Question 3 – Exception for onerous sales and insurance contracts</p> <p>Paragraph B9 of Appendix B [of the Exposure Draft] proposes a limited exception for onerous contracts arising from transactions within the scope of IAS 18 <i>Revenue</i> or IFRS 4 <i>Insurance Contracts</i>. The relevant future outflows would be the costs the entity expects to incur to fulfil its contractual obligations, rather than the amounts the entity would pay a contractor to fulfil them on its behalf.</p> <p>Paragraphs BC23–BC27 of the Basis for Conclusions explain the reason for this exception.</p> <p>Do you support the exception? If not, what would you propose instead and why?</p>	<p>If the IASB follows the AASB's recommendation to develop consistent measurement principles for all liabilities through its conceptual framework project, there would be no need to provide this exemption. However, if the IASB does not follow that recommendation, the AASB would support the limited exemption.</p>	<p>The FRSB does not support the limited exception. The IASB should establish a principle and apply this simultaneously and consistently across all similar items. If liabilities were measured based on a fulfilment notion rather than a transfer price notion, there would be no need to apply a different measurement approach onerous contracts.</p>	<p>The FRSB and AASB both support application of a consistent measurement principle across all classes of liabilities. However, their preliminary views differ regarding whether to provide an interim exception for some onerous contracts until such consistency is achieved.</p> <p>The FRSB does not support the limited exception.</p> <p>If the IASB proceeds with its proposals, the AASB supports the limited exception.</p>

Attachments

B7.1 Draft FRSB comment letter on IASB Exposure Draft *Measurement of Liabilities in IAS 37*

B7.2 AASB issues paper: AASB's specific comments on IASB Exposure Draft ED/2010/1 *Measurement of Liabilities in IAS 37**

B7.3 Memo from Clive Brodie, Mischa Ginns and Jim Paul: Consider need for PBE/NFP modification to IFRS to replace IAS 37

B7.4 IASB Exposure Draft *Measurement of Liabilities in IAS 37*

B7.5 IASB's Working draft of IFRS to replace IAS 37: *Liabilities* (Note: the working draft includes references to both the IASB's 2005 exposure draft and the IASB's Decision Summary. If you require copies of these, they are available on the IASB's project website <http://www.iasb.org/Current+Projects/IASB+Projects/Liabilities/Liabilities.htm>.

Otherwise, contact Clive Brodie clive.brodie@nzica.com or Mischa Ginns mginns@asb.gov.au).

B7.6 FRSB/AASB *Process for Modifying IFRSs for PBE/NFP*

- * This issues paper includes cross-references to Appendices A and B thereto. Appendices C and D are not cross-referenced—these are proposed to be the subject of the covering letter to the AASB submission.