



**Comment due date
extended to 3 May 2010**

8 January 2010

To: **Members of the Hong Kong Institute of CPAs**
All other interested parties

**INVITATION TO COMMENT ON IASB EXPOSURE DRAFT OF
MEASUREMENT OF LIABILITIES IN IAS 37**

Comments to be received by 29 March 2010

The Hong Kong Institute of Certified Public Accountants' (Institute) Financial Reporting Standards Committee (FRSC) is seeking comments on the IASB Exposure Draft which has been posted on the Institute's website at:

<http://www.hkicpa.org.hk/en/standards-and-regulations/standards/financial-reporting/exposure-drafts/>.

The Exposure Draft contains one section of a replacement for IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The section contains revised proposals for measuring liabilities within the scope of IAS 37.

IAS 37 applies to liabilities not covered by other accounting standards, such as liabilities to decommission assets and liabilities arising from legal disputes. The IASB previously published proposals to amend IAS 37, including revised measurement requirements. In the light of the comments received the IASB identified a need to develop more guidance on one part of those proposals: the measurement of these liabilities.

The Exposure Draft proposes that the measurement of the liability should be the amount that the entity would rationally pay at the measurement date to be relieved of the liability. Normally, this amount would be an estimate of the present value of the resources required to fulfill the liability. The estimate would take into account the expected outflows of resources, the time value of money and the risk that the actual outflows might ultimately differ from the expected outflows.

--- A summary prepared by the IASB on the Exposure Draft is set out in the attached Appendix.

In accordance with the Institute's Convergence Due Process, comments are invited from any interested party. The FRSC would like to hear from both those who do agree and those who do not agree with the proposals contained in the IASB Exposure Draft.

Comments should be supported by specific reasoning and should be submitted in written form.

To allow your comments on the IASB Exposure Draft to be considered, they are requested to be received by the Institute on or before **29 March 2010**.



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Comments may be sent by mail, fax or e-mail to:

Steve Ong
Director, Standard Setting
Hong Kong Institute of Certified Public Accountants
37th Floor, Wu Chung House
213 Queen's Road East
Wanchai, Hong Kong

Fax number (+852) 2865 6776
E-mail: commentletters@hkiipa.org.hk

Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

SNAPSHOT: IAS 37 replacement

Overview

- Project objectives** To improve and align the recording of liabilities across IFRSs, and to support global convergence of financial reporting standards.
- Project stage** In 2005, the IASB published for public comment an exposure draft of a standard to replace IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. After reviewing the responses to that exposure draft, the IASB has reached decisions on most of the principles to be included in the new standard (an IFRS). However, in the light of the comments received, the IASB has developed more guidance on the proposed measurement requirements.
- It is now seeking public comment on the draft measurement guidance in an exposure draft *Measurement of Liabilities in IAS 37*, published on 5 January 2010.
- Comment deadline** The exposure draft is open for public comment until 12 April 2010.
- Next steps** The IASB plans to post a working draft of the new IFRS on its website in February 2010. This will contain both the draft measurement guidance and near-final wording for the rest of the standard. It expects to issue the new IFRS in the third quarter of 2010.

Which liabilities are we addressing?

The new IFRS will replace IAS 37 and apply to all liabilities that are not within the scope of other standards.

The new IFRS will apply to liabilities such as:

- liabilities arising from legal disputes,
- statutory asset decommissioning obligations,
- other environmental obligations, and
- liabilities arising under contracts that have become onerous.

However, it will not apply to items such as financial liabilities, pension liabilities, income tax liabilities and insurance liabilities, because they are within the scope of other standards.

Why are we undertaking this project?

The IASB initiated a project to replace IAS 37 for three main reasons.

1. Addressing inconsistencies with other IFRSs

IAS 37 requires an entity to record an obligation as a liability only if it is probable (ie more than 50 per cent likely) that the obligation will result in an outflow of cash or other resources from the entity. Other standards, such as IFRS 3 *Business Combinations* and IAS 39 *Financial Instruments: Recognition and Measurement*, do not apply this 'probability of outflows' criterion to liabilities.

2. Global convergence of accounting standards

In response to requests from many parties, and supported by the G20, the IASB is seeking to eliminate differences between IFRSs and US generally accepted accounting principles (US GAAP). At present, IFRSs and US GAAP differ in how they treat the costs of restructuring a business. IAS 37 requires an entity to record a liability for the total costs of restructuring a business when it announces or starts to implement a restructuring plan. In contrast, US GAAP requires an entity to record a liability for individual costs of a restructuring only when the entity has incurred that particular cost.

3. Improvements to the measurement of liabilities in IAS 37

The requirements in IAS 37 for measuring liabilities are unclear. As a result, entities use different measures, making it difficult for analysts and investors to compare their financial statements. Two aspects of IAS 37 are particularly unclear:

- IAS 37 requires entities to measure liabilities at the 'best estimate' of the expenditure required to settle the obligation. In practice, there are different interpretations of what 'best estimate' means: the most likely outcome, the weighted average of all possible outcomes or even the minimum or maximum amount in the range of possible outcomes.
- IAS 37 does not specify the costs that entities should include in the measurement of a liability. In practice, entities include different costs. Some entities include only incremental costs while others include all direct costs, add indirect costs and overheads or use the prices they would pay contractors to fulfil the obligation on their behalf.

Where are we with the proposals?

The IASB published an exposure draft in 2005. Having considered the comments received, the IASB has finalised its decisions on the criteria for recording liabilities and on restructuring costs.

Following its review of the responses to the 2005 exposure draft, the IASB has decided:

- that the new IFRS will not include the 'probability of outflows' criterion.

Instead, an entity should account for uncertainty about the amount and timing of outflows by using a measurement that reflects their expected value, ie the probability-weighted average of the outflows for the range of possible outcomes.

- that the new IFRS will require an entity to record a liability for each individual cost of a restructuring only when the entity incurs that particular cost.

However, respondents to the 2005 exposure draft voiced concerns that the proposals on measurement lacked clarity. In response to those concerns, the IASB has developed more guidance and published the draft guidance on 5 January 2010 in an exposure draft *Measurement of Liabilities in IAS 37*.

What measurement guidance does the exposure draft propose?

The exposure draft proposes that the measurement should be the amount that the entity would rationally pay at the measurement date to be relieved of the liability.

Normally, this amount would be an estimate of the present value of the resources required to fulfil the liability. The estimate would take into account the expected outflows of resources, the time value of money and the risk that the actual outflows might ultimately differ from the expected outflows.

- If the liability is to pay cash to a counterparty (for example to settle a legal dispute), the outflows would be the expected cash payments plus any associated costs, such as legal fees.
- If the liability is to undertake a service—for example to decommission plant—at a future date, the outflows would be the amounts that the entity estimates it would pay a contractor at the future date to undertake the service on its behalf.

The IASB believes that contractor prices provide a more objective basis for assessing future outflows than estimates that are based on the costs that the entity would incur if it undertook the work itself. In addition, by specifying an overall objective (contractor prices), the IFRS would not need detailed and essentially arbitrary rules on which costs should be included.

Are there any other changes to the previous proposals?

The IASB made some other changes to the proposals in response to feedback on its 2005 exposure draft. However, because most of the changes respond to comments received or are minor, the IASB is not re-exposing those proposals.

The Liabilities—Amendments to IAS 37 project page on <http://go.iasb.org/Liabilities> provides a link to a decision summary that contains both the proposed measurement guidance and the other decisions that will appear in the new IFRS

In addition, the IASB is preparing a working draft of the proposed new IFRS and aims to post it on its website in February 2010. This will contain both the proposed measurement guidance and near-final wording for the rest of the standard. Thus, interested parties will be able to see the draft measurement guidance in the context of the IFRS as a whole.

What happens next?

The IASB welcomes comments on the exposure draft *Measurement of Liabilities in IAS 37*. The deadline for comments is 12 April 2010. The IASB will review all responses in public meetings. As usual, the IASB will announce meetings on its website.

The IASB is aiming to issue an IFRS to replace IAS 37 in the third quarter of 2010.