

# Proposals to change the measurement of non-financial liabilities

## Background

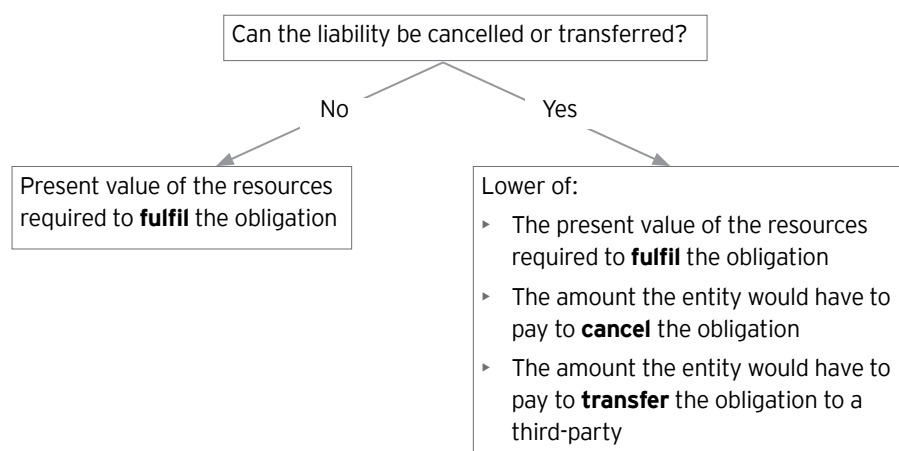
The IASB has published for comment a revised exposure draft (ED) of the measurement section of the replacement for IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. IAS 37 applies to non-financial liabilities not covered by other accounting standards and includes liabilities such as the decommissioning of assets, environmental clean-up or rehabilitation, obligations under onerous contracts and liabilities arising from legal disputes.

In June 2005, the IASB published its first ED of a standard to replace IAS 37, which included proposals to revise the measurement requirements. In particular, it proposed to replace the measurement requirement of the liability at the "best estimate of expenditure required to settle" it with "the amount that an entity would rationally pay to settle or transfer" it. However, respondents to the 2005 ED were concerned that the proposals on measurement lacked clarity.

Accordingly, the IASB has proposed additional guidance on the measurement requirements in ED/2010/1.

## Summary of proposals

The ED proposes that the non-financial liability should be measured at the amount that the entity would rationally pay to be relieved of the liability. This amount is dependent on whether or not the liability can be cancelled or transferred, as illustrated in the following flowchart:



The amount that an entity would have to pay to **cancel** or **transfer** an obligation is the price the counterparty or a third-party would demand, plus any costs of cancellation or transfer.

If the outflow of resources required to **fulfil** the obligation are uncertain, the entity would estimate their expected value. This is the probability-weighted average of the outflows for the range of possible outcomes, adjusted for the risk that the actual outflows of resources might ultimately differ from those expected. The risk adjustment measures the amount, if any, the entity would rationally pay in excess of the expected present value of the outflows to be relieved of this risk.

If the liability is to undertake a service at a future date – for example to decommission a plant – 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. That is, it includes the profit margin of a contractor. This is irrespective of whether or not the entity intends to undertake the activity itself rather than engage a contractor.

However, if the obligation to undertake a service is an onerous contract arising from transactions within the scope of IAS 18 *Revenue* or IFRS 4 *Insurance Contracts*, the future outflows are the costs expected to fulfil the obligation rather than the costs that would be paid to a contractor.

## Effective date and transition

The ED and the accompanying materials neither indicate an effective date for the final standard nor revise the transitional provisions in the 2005 ED. However, the IASB expects to issue the final standard in the third quarter of 2010. In its December 2009 meeting the IASB tentatively decided that major projects completed in 2010 should not become effective earlier than for annual periods beginning on or after 1 January 2012.

### Status of other changes to the 2005 ED

- ▶ No re-exposure of remaining proposals in the 2005 ED
- ▶ Project-related IASB documents available include:
  - ▶ Snapshot: high level summary of all proposals to appear in the new standard
  - ▶ Decision summary
- ▶ IASB is to post a working draft of the entire IFRS in February 2010

## Business impact

The proposed clarifications on the measurement requirements for non-financial liabilities will likely require significant new processes to be introduced and changes to the information systems to capture more information. Entities will have to obtain evidence of the range of possible outcomes and their probabilities. This may be a timely and costly exercise for some entities.

As the final amount recognised for the liability will no longer represent possible outflows but a probability-weighted average of possible outflows, further disclosure to the shareholders may ultimately be required to explain how the amount was determined.

In combination with the changes to the recognition criterion, the new standard will likely have a significant effect on the financial position of many entities. For some, liabilities may be recognised earlier, and be recognised at higher amounts than they are today. For other entities it may result in a reduction in the overall value of liabilities. All entities will need to carefully evaluate the effect of this on financial ratios and debt covenant compliance.

Comments on the ED are due by 12 April 2010.

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