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E-mail: [commentletter@efrag.org](mailto:commentletter@efrag.org)

10 May 2010

Ref.: ACC/HvD/LF/ID

Dear Ms. Flores,

**Re: FEE Comments on EFRAG's Amended Draft Comment Letter on IASB Exposure Draft *Measurement of Liabilities in IAS 37***

- (1) FEE (the Federation of European Accountants) is pleased to provide you below with its comments on the Amended EFRAG Draft Comment Letter on the IASB Exposure Draft *Measurement of Liabilities in IAS 37* (the "ED").
- (2) FEE noted EFRAG's additions to its draft comment letter on the IASB ED *Measurement of Liabilities in IAS 37* (issued in February 2010), following the publication of the IASB working draft of the new IFRS to replace IAS 37 ("the working draft"). We also noted that constituents that have already submitted their replies to EFRAG are welcomed to comment only on the additions.
- (3) Since the FEE comment letter to EFRAG's draft letter on the IASB Exposure Draft *Measurement of Liabilities in IAS 37* was developed before these additions, the comments in the present letter are limited to these additions but should be read in conjunction with the FEE comment letter on IAS 37 already sent to EFRAG on 20 April 2010.
- (4) In summary, we share the additional concerns expressed by EFRAG in its amended draft comment letter, as explained below.

**Proposed scope (paragraphs 2 to 7 of the IASB working draft)**

- (5) We agree with EFRAG that warranties should stay in the scope of the new IFRS replacing IAS 37 until completion of the new IFRS replacing IAS 18 on Revenue Recognition and of the new IFRS on Insurance contracts. It should be noted that we view this proposal simply as a transitional arrangement.

- (6) We believe that referring to the new IFRS for insurance contracts is relevant since the IASB is currently in the process of developing the expected Exposure Draft on Insurance contracts and the comments on IAS 37 should not prejudice the expected debate on the forthcoming replacement of IFRS 4 on Insurance contracts. Therefore, we suggest that EFRAG adds a reference to the new IFRS for insurance contracts also in its final comment letter to the IASB.
- (7) As a drafting comment, we note that paragraph 13 (a) in EFRAG's amended draft comment letter should be corrected to read "are in the scope of another Standard", as opposed to "are not in the scope of another Standard".

#### **Questions to constituents**

Do constituents agree with the IASB proposal that when there is uncertainty management should assess whether an obligation exists without applying a probability threshold?

Do constituents believe that the principle and guidance on uncertainty in paragraphs 13 and following of the working draft is sufficient? If not, what type of additional guidance is needed?

Do constituents believe that an entity should recognise a provision in a scenario as the one presented in paragraph 36 above (where the entity is uncertain about the existence of an obligation but will incur unavoidable cost)?

What are constituents' views about constructive obligations?

#### **Constructive obligations**

- (8) Like EFRAG, we believe that the distinction between economic compulsion and constructive obligation is not well established in the working draft. The distinction between the two notions is critical since, as explained in paragraph 10 of the working draft, actions arising from economic compulsion do not result in recognition of a liability whereas constructive obligations give rise to a liability as explained in paragraph 12 of the working draft. Accordingly, we agree with EFRAG that more extensive guidance is necessary on this matter.
- (9) The application guidance on restructuring costs, in particular paragraph C4 of the working draft, is a clear example that highlights the need for better guidance on what distinguishes economic compulsion from constructive obligation and the principles that result in a different accounting between the two. Indeed, paragraph C4 explains that even though an entity has announced a restructuring plan or starts to implement such a plan, it does not necessarily have an obligation for costs of individual elements of the plan. This conclusion appears to result from the requirement of paragraph 10 of the working draft. However, it is not clear why, having announced a detailed plan and started to implement such a plan, the entity would not be considered to have a constructive obligation meeting the requirements of paragraph 12(a). We believe that it is critical that the Board clarifies this issue.

- (10) We believe that the scenario presented by EFRAG in paragraph 36 of its amended draft letter (where the entity is uncertain about the existence of an obligation but will incur unavoidable cost) further highlights the need for clearer guidance on the definition of a constructive obligation. Indeed, we believe that the Board should specify whether constructive obligations can only arise from an entity's own actions (as per the situations specified in paragraph 12 of the working draft) and whether past actions by others in similar situations, for example a history of out of court settlement by other entities in the same jurisdiction when faced with a particular claim, result solely in an economic compulsion by the entity to act in the same manner (i.e. no liability would be recognised under paragraph 10 of the working draft).

#### **Removal of the “probability of outflows” criterion**

- (11) Like EFRAG, we disagree with the removal of the “probability of outflows” recognition criterion, as referred to by EFRAG.
- (12) In our view, when there is uncertainty, we do not consider it appropriate that management should assess the existence of the obligation without applying, at least to some degree, some type of a probability threshold. In practice, we do not see how judgement could be applied in assessing if an obligation exists without any inclusion of probability criterion.
- (13) In addition, we note that there is limited guidance on the existence of an obligation. Without use of a probability criterion, entities could end up recognising an obligation even though the probability of outflow of resources is very low (which would probably bring into existence the existence of the obligation). We do not think that the recognition of an obligation under these circumstances would provide relevant information.
- (14) In particular, we share EFRAG's concerns about the practical implications of the new proposals in dealing with non-contractual obligations such as litigations. Indeed, while it may be conceptually appropriate to consider that an obligation should only be recognised when an entity is in fact guilty of an offence, the entity cannot substitute itself to the justice system in establishing its guilt. Instead, in preparing its financial statements, the entity should assess the possible financial consequence of the pending litigation (i.e. the probability of outflow). Accordingly, establishing the existence of an obligation based on the probability that the litigation will result in an outflow of resources is a reasonable approach to resolve the issue.
- (15) Additionally, we do not believe that the “probability of outflow” criterion has been a source of abuse or diversity in practice until now. Accordingly, we do not believe that elimination of this criterion is warranted, in particular since we are not convinced that the approach provided in the working draft would result in improved information.
- (16) Finally, we agree with EFRAG that the guidance provided on conditions of uncertainty and sources of uncertainty does not appear sufficiently clear to ensure consistent application.

**Additions to comments on the measurement of obligations fulfilled by undertaking a service**

- (17) In our view, and in line with EFRAG's comments, there is a need for greater clarity on how an entity would be able to arrive at the estimation of the value of the services in the absence of a market for the service.

For further information on this letter, please contact Leyre Fuertes, Project Manager.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Hans van Damme', is written over a horizontal line. The signature is stylized and includes a large circular flourish on the left side.

Hans van Damme  
President