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14 May 2010

International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
United Kingdom
Email: CommentLetters@iasb.org

Dear Sir/Madam

SAICA SUBMISSION ON EXPOSURE DRAFT *MEASUREMENT OF LIABILITIES IN IAS 37* – PROPOSED AMENDMENTS TO IAS 37 – *PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS*

In response to your request for comments on the IASB's exposure draft, *Measurement of Liabilities in IAS 37* – Proposed amendments to IAS 37*,* attached is the comment letter prepared by The South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but also secretariat for the Accounting Practices Board (APB), the official standard-setting body in South Africa. The SAICA comment letter results from deliberations of the Accounting Practices Committee (APC), which is the technical advisory body to the APB.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director Accounting

cc: Moses Kgosana (Chairman of the Accounting Practices Board)
Prof Alex Watson (Chairman of the Accounting Practices Committee)

Integritas, 7 Zulberg Close, Bruma Lake, 2198 POSTAL ADDRESS PO Box 59875, Kengray, 2100, Johannesburg
TEL +27 11 621 6600 FAX +27 11 621 3321 CALL CENTRE 08610 SAICA (72422) EMAIL saica@saica.co.za WEB saica.co.za | accountancysa.org.za

SAICA SUBMISSION ON EXPOSURE DRAFT *MEASUREMENT OF LIABILITIES IN IAS 37* – PROPOSED AMENDMENTS TO IAS 37

GENERAL COMMENTS

We are supportive of including additional guidance on the measurement model for liabilities under IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets*. However, we have reservations relating to the proposed measurement model for obligations that will be fulfilled by performing services.

The manner in which service liabilities will be measured could result in substantial changes to current practice. The proposed measurement model introduces the concept of measuring "value" given away as opposed to the actual cost incurred. This may result in a profit being recognised on internal activities performed when the related services are performed by the entity itself and many constituents were not in agreement with this approach. This is a relatively new concept that will be introduced into IFRS.

In addition, most of the constituents believe management's intention should be considered as management are unlikely to *"rationally"* pay more than the amount the services would cost the entity. For example, if management had to perform a service and were to pay someone to perform the service, we believe it would be appropriate to use the cost to be paid. Alternatively, if the service were to be performed internally by the entity, it would be more appropriate to use the cost to be incurred, as this would result in profit or loss excluding internally generated profits.

SPECIFIC COMMENTS

Question 1 – Overall requirements

The proposed measurement requirements are set out in paragraphs 36A–36F. Paragraphs BC2–BC11 of the Basis for Conclusions explain the Board's reasons for these proposals.

Do you support the requirements proposed in paragraphs 36A–36F? If not, with which paragraphs do you disagree, and why?

Whilst we are supportive of certain of the changes proposed in the exposure draft, we have highlighted certain areas which we believe require further discussion or consideration by the Board:

- Paragraphs 36A and 36B do not specifically state that, when the obligation is to fulfilled by undertaking a service, the amount of the obligation should be determined from a contractor's perspective and that one needs to apply the same measurement bases whether or not an entity will be engaging an external contractor or providing the service itself. Paragraph B8 states that the obligations for fulfilling future services should be measured with reference to the amounts of outflows that an entity would rationally pay a contractor. It is only when 36A and 36B are read together with B8 that this measurement principle is understood. Paragraphs 36A and 36B could be misinterpreted to imply that where an entity will perform the services itself, the amount of the liability should be the costs expected to be incurred by that entity. In light of this, we suggest that if the Board continues with its present measurement proposals that it also makes it clear in the **body** of the proposed standard that the outflows for obligations to be fulfilled by undertaking a service will be measured as the amounts that an entity would rationally pay a contractor at the future date to undertake services on its behalf.

- The guidance in B1(a) stipulates that the present value of 'resources' required to 'fulfil' an obligation should be estimated by taking into account the 'expected outflows of resources'. Under IFRS, 'resources' in the context of settling a liability is generally interpreted to mean the 'cost of such resources' as opposed to 'value' of those resources. This concept of 'value of resources' could, in our view, be confusing as this is inconsistent with the current IFRS requirements. For example, it is not clear how this interacts with the amount of the provision that is included in the cost of property, plant and equipment as defined in paragraph 16 of IAS 16 – *Property, Plant and Equipment.* This paragraph defines cost of property, plant and equipment to include the 'initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located'. It would appear that the cost of property, plant and equipment specifically excludes profit margins in respect of self-constructed assets. Under the proposed amendments, it is clear that 'value of resources' should be interpreted as the cost plus a profit margin (i.e. value). If this were the measurement model to be applied, B1 should clearly articulate that this is not only the cost but also value given away. We also urge the Board to consider the potential implications of the proposals to current IFRSs.
- As noted under the general comments section, we have concerns with the use of "value" in instances where the services are to be performed internally by the entity. Although we acknowledge that determining the cost is often complex, we believe that management's intention should be considered and that the expected outflow should not include internal profits from the entity providing services to itself.
- Paragraph BC15(a) states that "*… The objective is to measure the liability at the end of the reporting period and to depict the uncertainties at that date, **not to predict the entity's future outflows**."* (emphasis added). We do not support the contention noted by the Board in BC15(a) that the objective of measuring the liability at the end of the reporting period is "*not to predict the entity's future outflows"* as this seems to be in conflict with the *Framework for the Preparation and Presentation of Financial Statements* which requires that an entity should provide information to enable users to better evaluate an entity's ability to generate cash and cash equivalents.

Question 2 – Obligations fulfilled by undertaking a service

Some obligations within the scope of IAS 37 will be fulfilled by undertaking a service at a future date. Paragraph B8 of Appendix B specifies how entities should measure the future outflows required to fulfill 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 Board's rationale for this proposal.

Do you support the proposal in paragraph B8? If not, why not?

In our deliberations on the inclusions of B8 our constituents had divided views as to whether or not the liability should be based on *"outflows that the entity would rationally pay a contractor at the future date to undertake the service on its behalf"*. Whilst we acknowledge the practical difficulties in determining the costs that should be included in calculating the present value that the entity would pay for such services, especially if these costs are to be incurred far in the future, we are of the view that there could be merits in taking into consideration management's intention for the reasons noted in the 3rd and 4th bullet in the response to question 1 above. In addition, in some cases there may be no external contractor providing the specified service.

If management's intention would be to not use an external contractor, we then believe the measurement should be based on the cost to be incurred as opposed to the fees payable to a contractor or the value of the service provided to an external party.

Question 3 – Exception for onerous sales and insurance contracts
Paragraph B9 of Appendix B proposes a limited exception for onerous contracts arising from transactions within the scope of IAS 18 Revenue or IFRS 4 Insurance Contracts. The relevant future outflows would be the costs the entity expects to incur to fulfill its contractual obligations, rather than the amounts the entity would pay a contractor to fulfill them on its behalf.

Paragraphs BC23–BC27 of the Basis for Conclusions explain the reason for this exception.

Do you support the exception? If not, what would you propose instead and why?

Yes, we support the limited exception for onerous contracts arising from transactions within the scope of IAS 18 – *Revenue* or IFRS 4 – *Insurance Contracts* on the basis that the projects on these two standards are in progress.

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