A F E P

Association Française des Entreprises Privées

IASB
30 Cannon Street
London EC4M 6XH
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Paris, 7 May 2010

Re: *ED "Measurement of liabilities in IAS 37"*

We welcome the opportunity to comment on the IASB exposure draft presenting proposed guidance to measure liabilities in IAS 37.

While we approve of the decision by the Board to expose measurement guidance for liabilities in IAS 37, we disagree that the Board could conclude on a series of issues without either more fundamental and conceptual analysis or re-exposure. The issues at stake are as follow:

- whether the probability recognition for liabilities should be removed is a decision that needs to be carefully considered and assessed as part of the conceptual framework project; as this remains to be done, no decision at standard level has the grounds necessary to be a valid decision other than to harmonise with other standards such as IFRS 3 Revised; moreover, the ED in 2005 *denied* that the proposals were in breach of the conceptual framework. In addition, references to IFRS 3 and IAS 39 in the background to the ED are highly irrelevant: recognition of contingent liabilities in business combinations has been and remains a controversial issue and financial instruments are sufficiently different from liabilities in the scope of IAS 37 to justify a different recognition pattern;

- determining whether in measuring assets and liabilities reference to a price leads to more useful information to users belongs to the measurement phase of the conceptual framework;

- Generalising the use of expected values for single obligations is also an issue that needs to be debated at the conceptual level. The existing conceptual framework and the revised first chapter on the objectives of financial reporting confirm that financial reporting should bring users the information needed to help them predict future cash flows, and not to present a valuation of the entity. Users have indicated to us that while indeed expected value is part of the pricing exercise, they are more interested in having knowledge of the worst case scenario (in the notes) and of management's cash-flow expectations (as a basis for measurement). Moreover, FASB has more than once debated with the IASB and privileged a most likely outcome approach for single obligations[1]. The decision reached by the FASB on uncertain tax positions is a recent example of such positions;

- The IASB's deliberations post the first ED consultation phase have highlighted the difficulty the Board encountered in defining when an obligation was deemed to arise and how to deal with uncertain obligations. The conclusion reached should be tested in order to ascertain whether the final standard runs a chance of being applied on a consistent basis, and to assess the burden and feasibility of identification of all present obligations. The questions participants have raised during the webcast sessions organised by the IASB – and answers provided – and the additional explanatory material on recognising liabilities arising from lawsuits that the IASB Staff has recently published are evidence that the requirements in the near final draft are lacking in clarity;

- We are uncertain as to whether warranty obligations fall within the proposed new IFRS, or within IAS 11 and IAS 18. Warranty obligations (other than guarantees that are transferred to a third-party insurer, which are within the proposed scope of IFRS 4 phase 2) would in our view fit within "liabilities arising from the application of the revenue recognition criteria in IAS 18 Revenue". As the Board has decided on onerous contracts, we believe the publication of a final standard on Liabilities should not alter the accounting requirements for warranty obligations, prior to the Revenue Recognition Project being completed. To that purpose we recommend that the future standards on Liabilities and on revenue recognition become effective at the same date.

  Focusing on measurement, we strongly disagree with the IASB's proposals. Our reasoning is as follows:

  - since IFRIC started their work, IAS 37 has not been subject to requests for interpretations; there is therefore no evidence of divergent practices; furthermore CESR indicates that enforcers have not encountered difficulties in how IAS 37 was to be applied, i.e. have not identified divergent practices either;

  - the decision by the Board to fundamentally change the measurement basis for liabilities (from cost to price for obligations to render services) while presenting the output of the deliberations as a mere clarification leads to serious inconsistencies in the measurement principles and guidance;

[1] Liabilities are measured on a weighted average basis only when no scenario is more likely than not to occur.

- we believe that all liabilities within the scope of IAS 37 should be measured at the present value of the resources expected to be sacrificed upon settlement; no profit margin should be included in the measurement of liabilities for the reasons exposed by the six dissenting members of the Board;

- in common with the dissenting Board members, we object to the lack of clarity or guidance about what the risk adjustment represents; we disagree strongly with the apparent requirement of paragraph B15 to include an adjustment representing the margin a third party would require to take on the risk and thereby relieve the entity of this; in particular, this appears to contradict the requirements of paragraph 36B by always placing the entity in the situation of a transfer to a third party;

- we disagree that the amount an entity would rationally pay should be the lowest amount possible; where the entity has a stated policy or an observed past practice of settling at a higher amount, we believe liabilities should be measured at the present value of the cash outflows the entity will incur at the time it satisfies its obligation. Only in this way will the information provided be of any use in helping users to forecast future outflows;

- The use of expected values for single obligations is not a sound basis for reliable and comparable information. The most likely outcome approach as in IAS 37 today is in our view adequate to provide the best estimate of the cost the entity is to incur, including the existing guidance when no scenario seems to be more likely than not;

- The simplified approach that the IASB wishes to introduce in stating that not all outcomes need to be taken into account opens the door to a great uncertainty in how to measure a liability and to a lack of consistency in practice.

Should you wish any supplementary comment or explanation, please do not hesitate to contact us.

ACTEO	AFEP	MEDEF
Patrice MARTEAU	**Alexandre TESSIER**	**Agnès LEPINAY**
Chairman	Director General	Director of economic and financial affairs

Appendix to ACTEO & MEDEF's letter of comments on the exposure draft presenting guidance on how to measure liabilities in IAS 37

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?

No, we do not agree with the requirements proposed in paragraphs 36A-36F for several reasons outlined below:

1- We disagree that the amount the entity would rationally pay should necessarily be the lowest amount possible. We believe that measurement should reflect the manner in which the entity is expected to satisfy its obligation, in accordance with stated policy or established past practice.

   In deciding how to discharge itself of a liability, the entity will consider the potential global cost, not only how much money is involved. For example, it might be more costly to reach an out-of-court settlement in litigation than go through the ordeal of a trial. Nevertheless an entity may rationally opt for the settlement option to avoid damaging publicity or breach of confidentiality.

   We therefore believe that the measurement principle should call for measuring liabilities at the present value of the cash outflows the entity is expected to incur, in accordance with how the obligation is expected to be discharged.

2- We believe that paragraphs 36A-36F that set the measurement principles for liabilities should clearly designate cost as the measurement attribute for all liabilities, notwithstanding the scenario, transfer, cancellation or fulfilment the entity is expected to adopt.

   In a principle based standard, the minimum requirement is to state measurement attributes clearly and to apply them consistently to all transactions scoped in the standard. This is also the minimum that can be expected from the rewriting of measurement principles in view of clarification.

   We note that paragraph 36D calls for liabilities to be measured at cost (the price the third party would demand plus any costs of cancellation or transfer) in case of transfer or cancellation. Instead of referring solely to Appendix B, paragraphs 36A-36F should also include a requirement to measure liabilities in a fulfilment scenario at cost.

Finally, we welcome the clarification that the costs of external and internal lawyers should be included in the measurement of the obligation, as this is the one area in IAS 37 where we are aware of divergence in practice. We recognise that there are sound arguments both for and against the inclusion of such costs as part of the liability but believe that this clarification will enhance comparability between entities.

3- We strongly oppose to the measurement guidance proposed in Appendix B. We believe that Appendix B:

- alters fundamentally the existing measurement guidance in IAS 37 although it is presented as a clarification – without change – of the existing requirements; indeed IAS 37 without any ambiguity calls for liabilities to be measured at cost (for example the example set in paragraph 39 of the standard clearly states "the expected value of the ***cost*** of repair" [emphasis added], even though the example illustrates an obligation to render a service. Examples provided in Appendix C to IAS 37 confirm that requirement (example 1: warranties "a provision is recognised for the best estimate of the ***costs***…" example 2A: "the best estimate of the ***costs*** of the clean-up"….etc…).

- Is likely to bring confusion and arbitrariness in the measurement of liabilities in the scope of IAS 37, whereas we believe IAS 37 is consistently applied at present; we do not believe that the description given by the Board of the diversity in practice is accurate.

4 - We disagree with:

- Extending the use of expected value to measure single obligations; we believe that the existing guidance in IAS 37 is far superior both in terms of relevance and clarity to what is proposed in Appendix B. In our view, paragraphs 39, 40, 42 and 43 of that standard provide clear principles for dealing with uncertainty in ways which are appropriate for different situations. As we have indicated above, we believe that the measurement of liabilities should reflect the most probable outflows of resources the entity expects from the discharge of its liabilities. Expected values are fully relevant to the estimation of the most probable outflows when the entity incurs a significant number of similar liabilities which can be taken together as a homogenous group.

- The apparent systematic inclusion of a risk adjustment representing "the amount that the entity would rationally pay in excess of the expected present value of the outflows to be relieved of this risk". This seems to represent the margin a third party would require to take on this risk from the entity, and therefore represents an additional layer of cost which would not result in cash outflows and is not appropriate for the measurement of the expected cash outflows unless it is the intention of the entity to transfer its obligation to a third party. Since this risk adjustment is required for the measurement of the obligation in accordance with paragraph 36B(a), it also results in a blurring of the distinction between that measurement and that of the amount the entity would have to pay to transfer the obligation to a third party in paragraph 36B(c). We expect this will result in confusion and hence wide diversity in practice.

If, on the other hand, this risk adjustment is intended to represent uncertainty as to the amount of the cash outflows required to fulfil the obligation, and we do think that this is implicit in the requirement of paragraph B5 (a) to "incorporate, in an unbiased way, all information about the amount..." in the estimate, then this guidance should make it very clear that this is what is intended. This additional adjustment appears to be superfluous. As stated above, we believe that the current guidance of IAS 37 is superior, both from a theoretical point of view and from the point of view of clarity.

- Measuring obligations other than those arising from customer contracts on the basis of a price rather than cost (see below) and hence introducing by the back door without any appropriate debate the beginning of a fair value notion in the measurement of liabilities falling in the scope of IAS 37.

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 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 Board's rationale for this proposal.

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

No we do not support the proposal in paragraph B8. We believe that the basis for measurement of liabilities in the scope of IAS 37 should be the cost to the entity of fulfilling its obligation.

We share the reasons explained by the six dissenting members of the Board. We would like to emphasise more particularly our disagreement with BC21 (e). We believe indeed that all activities are necessary to create value for the capital providers. We believe value is nonetheless effectively created ***only when those activities culminate in value-creating transactions***. We believe also that one of the primary objectives of financial reporting is ***to measure value created***. As a result, measuring creation of value on purely hypothetical bases is not only useless but particularly confusing for users.

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 and IFRS 4 Insurance Contracts. 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.

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?

We believe that all liabilities arising from customer contracts should be scoped out of IAS 37. Guidance on how to deal with warranties and onerous contracts is expected to be developed in the future standard on revenue recognition. As a result we believe that the future standard on liabilities should not come into force before the future revenue recognition standard does.

It follows from our answer to questions 1 and 2 that we have no objection to onerous contracts being measured on the basis of the costs necessary to fulfil their contractual obligations, irrespective of whether these arise from contracts which fall within the scope of the future standards on revenue recognition or insurance contracts.