Disclosures of Contractual Commitments

Extract, IFRS Discussion Group Report on Meeting – September 11, 2014

The role of management ability and/or intent in accounting for assets and liabilities under IFRSs is somewhat inconsistent. In some cases, an entity’s plans and expectations may factor into the nature and/or type of asset or liability recorded in the financial statements, as well as its presentation. Other areas of IFRSs are equally clear in describing the extent to which management intent is precluded. Some fundamental accounting concepts focus on an entity’s ability (rather than intent) to do something, while still other standards refer to both notions of ability and intent.

The ability to avoid costs regardless of intent is a key concept in IAS 37 Provisions, Contingent Liabilities and Contingent Assets and factors into the determination of whether an obligation exists at the reporting date. The same concept appears to affect the determination of whether disclosures of certain contractual terms and commitments are required under IFRSs.

**Issue: To what extent is the ability to avoid future expenditures relevant for IFRS disclosure purposes?**

The term “commitment” is not defined in IFRSs. However, with respect to liabilities, The Conceptual Framework for Financial Reporting notes that a decision by management to acquire assets in the future does not, of itself, give rise to a present obligation unless the entity enters into an irrevocable agreement to acquire the asset.

Some IFRSs (such as IFRS 12 Disclosure of Interests in Other Entities, IAS 17 Leases, and IAS 24 Related Party Disclosures) provide some detail on the notion of “commitment” to which their disclosure objective relates, even if they do not define that term.

Given that commitments are undefined in the literature, it might appear from Chapter 4: The 1989 Framework: the remaining text, that irrevocability is a key differentiating feature, even for disclosure purposes. Future commitments, much like the management decisions that give rise to them, can be rescinded or cancelled. Is there a clear and consistent disclosure principle for commitments in the literature? Further, to the extent they are cancellable, does management’s ability to cancel an agreement and, as a result, avoid the future expenditure, render the disclosure of such commitments relevant to financial statement users?

**View A – Unrecognized contractual commitments are disclosed regardless of management’s ability or intent to avoid the commitment, unless a specific standard specifies otherwise.**

Unless specific reference is made in the standards, the disclosure is required. While IAS 17 requires disclosure of total future minimum lease payments under non-cancellable operating leases, IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets, in contrast, do not distinguish between cancellable and non-cancellable commitments for the acquisition of property, plant and equipment and intangible assets for disclosure purposes. Therefore all such commitments are disclosed.

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1 In contrast, “firm commitment” and “firm purchase commitment” are defined terms in IFRSs.

Source: [www.frscanada.ca/ifrs-discussion-group](http://www.frscanada.ca/ifrs-discussion-group)
The threshold for disclosure in IAS 24 could be especially low, given the relationship of the parties behind the contractual commitment, and the objective of the standard to highlight to users the potential effect such relationship has on the financial statements. In this case, the ability or intent to cancel the commitment is a term and/or condition of the agreement that requires disclosure under IAS 24, and not a feature that determines whether disclosure is made. Consequently, many commitments and executory contracts could potentially be affected (for example, goods and services outside the scope of IAS 16, IAS 17 and IAS 38).

Paragraph 114(d) of IAS 1 Presentation of Financial Statements includes contingent liabilities and unrecognized contractual commitments in its discussion of items to be presented in the notes to the financial statements. View A takes a literal read of this paragraph to encompass disclosure of all such contractual commitments over and above specific requirements in the standards, irrespective of the ability and/or intent to cancel.

View B – Unrecognized contractual commitments are disclosed having regard to management’s ability or intent to avoid the commitment, in addition to other factors specific to an entity.

View B approaches the disclosure requirements at the level of the specific standard first. If non-cancellability is specific to the disclosure requirement, disclosures of cancellable and/or avoidable commitments are made in relation to an entity’s particular facts and circumstances and judgment is required.

Management’s ability to cancel the contract renders the disclosure of all such cancellable contracts less relevant to users of financial statements. As there is no binding obligation on the entity and management can unilaterally avoid future expenditures under the contract, there is no risk that the entity could fail to meet a commitment that could result in a cash outflow in the future. Therefore, disclosure of such information is not meaningful.

The argument that disclosure of cancellable commitments is not meaningful appears to analogize to the measurement requirements for onerous contracts in IAS 37. If management is able to cancel the contract for no cost, no provision is required for onerous contracts. It would then follow that where an unrecognized contractual commitment can be cancelled for no cost, no disclosure of such commitment is required (as in substance, it does not exist).

View B does not interpret paragraph 114(d) of IAS 1 to be an all-encompassing disclosure requirement for unrecognized contractual commitments. The paragraph is regarded as a general discussion pertaining to the structure and ordering of notes to the financial statements rather than their specific content. This view also considers the perceived lack of a broad disclosure requirement for all contractual commitments (cancellable or not) as an indication that the IASB has applied the cost constraint principle on useful financial reporting.
Entities routinely enter into company-wide executory contracts to which they are contractually committed (for example, long-term employee contracts, IT/telecom service provider contracts). Those contracts may be more significant to the ongoing operations of the business than open purchase orders for items of property, plant and equipment. However, they are not disclosed in the notes to the financial statements even if they are non-cancellable.

The Group’s Discussion

Group members expressed a number of general thoughts on what should be disclosed in various circumstances, including a common understanding that irrevocable commitments requiring an outflow of economic benefits are required to be disclosed in accordance with IAS 37. In other circumstances, if no specific IFRS requirements apply, the extent of disclosure to meet IAS 1 requirements is based on professional judgment with a view to providing relevant information to users of financial statements.

Some factors to consider when deciding on the appropriate level of disclosure under IAS 1 include the following:

- whether the commitment is significant to the entity’s operations;
- if the commitment is required to maintain key assets of the company;
- whether it is practical for management to cancel the commitment; and
- the conditions in the agreement with respect to cancelability.

The Group’s discussion raises awareness about this item. The Group is not aware of diversity in practice and did not recommend any further action to be taken.