

**Staff Paper: PBE/NFP-specific modification to the IFRS
expected to replace IAS 37**

1. This paper addresses the public benefit entity/not-for-profit entity (PBE/NFP)-specific modification to be made to the replacement Standard expected for AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*, which is to effectively repeat the existing PBE/NFP-specific modification to IAS 37 contained in paragraphs Aus26.1 and Aus26.2 of AASB 137. To that end, this paper:
 - (a) notes the decisions made by the AASB and FRSB at their April and May 2010 meetings, respectively;
 - (b) discusses various candidates for the new PBE/NFP-specific modification;
 - (c) sets out the recommendations of AASB staff; and
 - (d) discusses the due process that should be followed in making the new modification.

Summary of AASB and FRSB decisions made at their April and May 2010 meetings, respectively

2. At its April 2010 meeting, the AASB decided that, in respect of public sector not-for-profit entities (NFPs), the expected new Standard replacing AASB 137 should preserve the present treatment of the items addressed by paragraphs Aus26.1 and Aus26.2 of AASB 137 (which are reproduced in Appendix A to this paper). The AASB also decided that, ideally, its PBE/NFP-specific modification should be expressed as a scope exclusion (consistent with the New Zealand PBE/NFP-specific modification of IAS 37), rather than as guidance (as is presently the case with the Aus paragraphs in AASB 137).
3. The aim of the AASB and FRSB is to achieve Australia/New Zealand convergence of the PBE/NFP-specific modification to the expected new IFRS *Liabilities*.
4. At its meeting on 3 May 2010, the FRSB decided to maintain the status quo by retaining virtually unamended the current New Zealand PBE/NFP-specific modification in NZ IAS 37 to the New Zealand Standard incorporating the new IFRS that replaces IAS 37. The only changes that might be made to the existing PBE/NFP-specific modification are those necessary to accommodate changes between IAS 37

and its replacement IFRS. As a consequence of this FRSB decision, the entities affected by the new Australian and New Zealand PBE/NFP-specific modifications would differ. The AASB decided in April 2010 that the scope exclusion should apply to public sector NFPs, whilst the FRSB decided in May 2010 that the scope exclusion should continue to apply to the Crown.

Candidate notions for a proposed PBE/NFP-specific scope exclusion

5. As a consequence of the FRSB's decision to retain virtually unamended the current New Zealand scope exclusion, the AASB staff independently worked on developing a PBE/NFP-specific modification for the Standard replacing AASB 137. The new modification has four objectives:
 - (a) to convert the Australian modification from guidance to a scope exclusion;
 - (b) to preserve the current treatment of announced intentions in the form of a local government's or government's existing public policies, budget policies, election promises or statements of intent;
 - (c) not to provide entities with an option not to recognise liabilities when present obligations (as defined in the Working Draft IFRS *Liabilities*) exist; and
 - (d) not to create uncertainty regarding whether the affected items should continue to be treated in the same manner as before.
6. Based on the advice of FRSB staff, achieving objective (b) would achieve Australia/New Zealand convergence in respect of the modification. This is because the outcome of applying the present New Zealand PBE/NFP modification is consistent with the outcome of applying the Aus paragraph modifications in AASB 137. The focus of Australia/New Zealand convergence is on converging outcomes, without necessarily adopting the same wording.
7. Based on these four objectives, AASB staff considered various candidate notions for the proposed PBE/NFP-specific modification (see discussion in paragraphs 10 – 37).
8. Paragraphs Aus26.1 and Aus26.2 of AASB 137 do not indicate that present obligations may not arise in respect of a local government's or government's existing public policies, budget policies, election promises or statements of intent. Rather,

those Aus paragraphs indicate that such an announced intention generally¹ is not of itself sufficient to create a present obligation; and provide examples of events that, together with an announced intention, give rise to a present obligation. Therefore, the challenge in developing a scope exclusion that is consistent with these Aus paragraphs (and therefore preserves the current treatment of the above-mentioned items) is to identify the underlying principle that excludes particular promises or items from being treated as liabilities.

9. The staff's analysis proceeded on the basis that a scope exclusion should not refer to obligations. This presumption was adopted even though, in common parlance, some of the items that the existing Aus paragraphs in AASB 137 identify as non-liabilities are often referred to as obligations. Because present obligations are liabilities, it would be inappropriate to exclude them from the scope of the Standard replacing AASB 137. Instead, the scope exclusion should identify more precisely the nature of the items it addresses—for example: promises, announced intentions, or social benefits.

Consideration of whether to adopt the wording in the New Zealand PBE/NFP amendment

10. In view of the FRSB's decision to retain the existing PBE/NFP modification virtually unamended, staff first considered whether to adopt the wording of the New Zealand modification, but make it applicable to all public sector NFPs—as per the AASB's decision in April 2010—rather than to 'the Crown'.
11. The New Zealand modification, the text of which is reproduced in Appendix B, excludes 'obligations expressed in legislation that have characteristics similar to an executory contract'. AASB staff have the following concerns with adopting this scope exclusion in an Australian context:
 - (a) it says the excluded items are obligations (liabilities) that are excluded because the community will, collectively, provide funds in the future under tax legislation (i.e., there are offsetting future inflows from assets). Depicting the

¹ There are exceptions to this general rule: see paragraph 25 for an example.

excluded items as obligations contradicts the objective that the scope exclusion should not be applicable to liabilities;

(b) it seems inappropriate to draw an analogy from contractual arrangements to non-contractual arrangements. The staff considers that so-called ‘social contracts’ are substantially different from legally binding contracts. Similarly, a right to tax is not necessarily equivalent to a right to receive benefits from counterparties to existing contracts; and

(c) introducing an analogy to executory contracts would adopt notions with which constituents are generally unfamiliar in this context.

12. AASB members previously expressed a disinclination to use the wording of the New Zealand scope exclusion. AASB staff propose not to adopt the New Zealand wording.

Other possible approaches

13. If the wording of the New Zealand scope exclusion is not adopted by the AASB, it is necessary to define the characteristics of a scope exclusion. Before considering possible defining characteristics of a scope exclusion, it is useful to note some key aspects of the guidance in the Working Draft IFRS *Liabilities* regarding the meaning of a present obligation.

Meaning of a present obligation in the Working Draft IFRS *Liabilities*

14. The Working Draft IFRS adopts the *Framework's* definition of a liability (paragraph 8) and indicates that an entity has an obligation only if:
- (a) it has a duty or responsibility to perform in a particular way; and
 - (b) it owes that duty or responsibility to another party or parties, who will either benefit from the entity's performance or suffer from its non-performance (paragraph 9).
15. Economic compulsion does not create an obligation. If an entity could avoid an expenditure by changing its operations, even if the entity is legally required to make

the expenditure if it operates in a particular way, the entity does not have an obligation for that expenditure (paragraph 10).

16. It is not necessary for the entity to know the identity of the party or parties to whom it owes an obligation (paragraph 11).
17. Legal enforceability is not essential for an obligation to exist. An entity might have a constructive obligation, but only if:
 - (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated that it will accept specific responsibilities;
 - (b) it has indicated its acceptance of those responsibilities to the parties that will benefit from their performance or suffer harm from their non-performance; and
 - (c) as a result, the entity has created a valid expectation among those parties that they can reasonably rely on it to discharge its responsibilities (paragraph 12).
18. A present obligation is an unconditional obligation that exists independently of future events (paragraph 18).
19. A decision by the management of an entity to undertake a restructuring does not create a liability for a cost associated with a restructuring. Even when the entity announces or starts to implement a restructuring plan, it does not incur an obligation for costs that it could avoid by changing or recalling the plan (paragraph C4).

Applying the guidance on the meaning of a present obligation in the Working Draft IFRS *Liabilities*

Announced intentions

20. To develop the characteristics of a scope exclusion using different wording from the New Zealand scope exclusion, staff considered first whether the scope exclusion should be **announced intentions** in the form of a local government's or government's existing public policies, budget policies, election promises or statements of intent. Such a scope exclusion would appropriately scope out future sacrifices of economic

benefits that the entity presently has the discretion to avoid making. However, it would also scope out some present obligations identified in the existing Aus paragraphs, such as obligations arising from beneficiaries having satisfied entitlement conditions in respect of announced intentions. Therefore, ‘announced intentions’ are, of themselves, imprecise as a scope exclusion. The AASB staff does not propose using ‘announced intentions’ as a scope exclusion.

Announced intentions without an accompanying liability trigger

21. To acknowledge that present obligations may arise pursuant to announced intentions (in the form of a local government’s or government’s existing public policies, budget policies, election promises or statements of intent), Agenda Paper 12.2 for the AASB’s 28 – 29 April 2010 meeting proposed scoping out obligations that arise **solely** from announced intentions. Ignoring for the moment the inappropriate reference to ‘obligations’, the staff considers, on reflection, that inserting ‘solely’ would merely beg the question of which events or circumstances cause an announced intention to become a liability. Therefore, a more specific scope exclusion is necessary if its meaning is to be clear.
22. One way of qualifying ‘announced intentions’ (in the form of a local government’s or government’s existing public policies, budget policies, election promises or statements of intent) would be to refer to the key principle in the extract above from the Working Draft IFRS *Liabilities*; namely, that an entity does not have a present obligation to sacrifice resources embodying economic benefits if it presently has the discretion to avoid that sacrifice. Thus, the scope exclusion for public sector NFPs could apply to:

‘announced intentions to sacrifice resources embodying economic benefits, in the form of a local government’s or government’s existing public policies, budget policies, election promises or statements of intent, that the entity presently has the discretion to avoid’ (**Approach 1**).²

² This notion is similar to the reference in the second sentence of paragraph Aus26.1 of AASB 137 to an intention to make payments that does not create a present obligation which is *binding*. The expression in Approach 1 is preferred by AASB staff because it is more closely aligned with the Working Draft IFRS *Liabilities*, and avoids referring to binding present obligations (which inappropriately implies some present obligations are non-binding).

23. For the FRSB's May 2010 meeting, FRSB staff proposed a similar but extended form of such a scope exclusion, which is called 'Approach 1A' in this staff paper. Because it is a variant of Approach 1, it is not discussed until later in this paper (see paragraphs 34 – 37).
24. AASB staff consider that the scope exclusion in Approach 1 above would accurately describe the items to be excluded from the new Standard (i.e., it would exclude the items that the Aus paragraphs in AASB 137 indicate would not be treated as liabilities), and would be principle-based. However, without supporting guidance, it may be unclear to readers of the Standard which announced intentions the entity presently has the discretion to avoid. The Aus paragraphs in AASB 137 effectively provide that guidance. If that guidance were not retained in some form, the risk arises of reopening the unresolved debate about which social benefit promises a public sector NFP has the discretion to avoid. One option for dealing with this issue is to simply state that the scope exclusion is not intended to change current practice. However, such a statement would not seem to belong in the body of the new Standard, and placing it elsewhere may cause some readers to overlook that point. In addition, some entities might presently be applying an inappropriate treatment. (From discussions with various Treasury and local government representatives, it seems that current practice is consistent with the Aus paragraphs in AASB 137; however, in view of the number of public sector NFPs in Australia, those enquiries were not exhaustive.) AASB staff are concerned that the new Standard or supporting explanations might run the risk of endorsing inappropriate treatments.

Nature of liability trigger accompanying announced intentions

25. Paragraph 18 of the Working Draft IFRS *Liabilities* says "A present obligation is an unconditional obligation that exists independently of future events. If an entity can avoid an obligation through its future actions, it does not have a present obligation." This speaks to many of the items intended to be covered by the scope exclusion, such as promised social benefits for which beneficiaries have yet to satisfy entitlement conditions. Therefore, a question arises whether Approach 1 could be clarified by identifying the **nature of events** that must occur to convert a mere promise (announced intention) into a present obligation. The staff observes that some announced intentions do not require a future event to convert them to a present

obligation. For example, some announced intentions may give rise to a present obligation to stand ready to make future sacrifices of resources embodying economic benefits, such as a government's announced intention to provide financial aid to victims of a disaster that has occurred. Therefore, the staff would not support portraying an announced intention as necessarily requiring a future event to occur before a present obligation arises.

Non-contractual promises

26. In many cases, the announced intentions to be covered by the scope exclusion are non-contractual promises. The staff considered whether the scope exclusion should focus on **non-contractual promises** to sacrifice resources embodying economic benefits, in the form of a local government's or government's existing public policies, budget policies, election promises or statements of intent. The staff noted that such a scope delimiter may be incomplete, because some multi-year public policy agreements (referred to in paragraph Aus26.1 of AASB 137) may be contractual agreements. The staff also noted that, consistent with AASB 137, the new Standard would require for-profit entities to recognise liabilities for some non-contractual promises in respect of environmental rehabilitation obligations owed to the community at large. It would seem inappropriate to focus on the non-contractual nature of some items as a basis for exclusion from the scope of the Standard, in respect of public sector NFPs, when some non-contractual promises of for-profit entities would be required to be recognised as liabilities.

Moral or economic compulsion

27. The AASB staff considered whether the scope exclusion should apply to announced intentions to sacrifice resources embodying economic benefits, which the entity is **morally or economically—but not legally—compelled to honour**. Such intentions would cover many of the items discussed in the Aus paragraphs in AASB 137. This form of scope exclusion would be consistent with the comment in paragraph 10 of the Working Draft IFRS that economic compulsion does not create an obligation. However, for the following reasons, AASB staff think it would be inappropriate to scope out announced intentions the entity is morally or economically—but not legally—compelled to honour:

- (a) it might be unclear which announced intentions an entity is morally or economically compelled to honour, particularly, for example, in respect of some social benefit programmes;
- (b) application of the principle might be unclear in relation to multi-year public policy grant agreements. Such agreements may be legally binding, although a present legal obligation to pay grants would not arise until the grantee meets conditions such as grant eligibility criteria or provides the services or facilities required under the grant agreement (see paragraph Aus26.1 of AASB 137). In the absence of guidance, the distinction between legally binding agreements and present legal obligations might be overlooked by some readers. Adding guidance on this point would contradict the AASB's objective of removing domestic interpretive guidance from the Standard; and
- (c) such a scope exclusion would imply that liabilities must be legally enforceable obligations. This would contradict the Working Draft IFRS *Liabilities*, which says a liability need not be legally enforceable, and identifies a constructive obligation as an example of a present obligation that might not be legally enforceable (paragraph 12). Present obligations to provide financial aid to victims of disasters that have occurred may be constructive obligations. Scoping out announced intentions the entity is morally or economically—but not legally—compelled to honour might permit entities not to recognise obligations that paragraph Aus26.2 of AASB 137 says are liabilities.

Announced intentions to provide social benefits

28. The AASB staff then considered whether the scope exclusion should be focused on announced intentions to provide **social benefits**. Social benefits include cash transfers such as unemployment benefits and social security pensions, and services such as public education and public health services. Such announced intentions could be extended to include multi-year public policy promises intended to *fund* the provision of social benefits. This broad notion of promises to provide social benefits would cover many of the items referred to in the Aus paragraphs in AASB 137. However, the staff has the following concerns with focusing the scope exclusion on announced intentions to provide social benefits:

- (a) 'social benefits' are not defined in the Australian literature. The IPSASB's exposure draft and consultation paper on social benefits include a definition of social benefits. However, that definition is inextricably linked to four other definitions, and including them would add considerable complexity to the scope exclusion;
- (b) because the IPSASB's definition of 'social benefits' is very broad, some announced intentions to provide social benefits are in fact present obligations. For example, paragraph Aus26.2 indicates that, in particular circumstances, an announced intention to provide financial aid to victims of a disaster gives rise to a present obligation. Such aid would meet the IPSASB's definition of 'social benefits'. Therefore, excluding all announced intentions to provide social benefits would inappropriately exclude some liabilities from the scope of the new Standard; and
- (c) once beneficiaries satisfy entitlement conditions in respect of announced intentions, a present obligation arises. Once again, excluding all announced intentions to provide social benefits would inappropriately exclude some liabilities from the scope of the new Standard.

Announced intentions to sacrifice economic benefits in non-exchange transactions

29. Another potential basis for a scope exclusion considered by the staff is announced intentions to sacrifice resources embodying economic benefits, in the form of a local government's or government's existing public policies, budget policies, election promises or statements of intent, in **non-exchange transactions**. The advantage of this approach is that many of the items discussed in the Aus paragraphs in AASB 137 relate to benefits to be provided in non-exchange transactions. The disadvantages are that:
- (a) some government guarantees are provided for public policy reasons without the government directly receiving approximately equal value in return (in some cases, no value is directly received in return). Therefore, excluding announced intentions to provide benefits in non-exchange transactions would

inappropriately exclude some liabilities from the scope of the new Standard;
and

- (b) a significant proportion of comment letters received on AASB ED 180/FRSB ED 118 *Income from Non-exchange Transactions (Taxes and Transfers)* indicated that the ED's distinction between exchange transactions and non-exchange transactions is unclear, perhaps inherently so. Therefore, basing a scope exclusion on whether promised transfers would occur in non-exchange transactions is likely to be difficult to apply, and may result in inconsistent application.

Scope exclusion in IPSAS 19

30. It might seem odd to wait until now to consider whether the scope exclusion should be the same as, or closely based on, the corresponding scope exclusion in IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. The scope exclusion in IPSAS 19 is considered here because (as noted below), it includes factors discussed separately above.
31. IPSAS 19, paragraph 1(a), scopes out “those provisions and contingent liabilities arising from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits”.
32. AASB staff think this scope exclusion in IPSAS 19 should not be adopted in the replacement Standard for AASB 137 because:
- (a) it indicates that particular present obligations need not be recognised (whereas the scope exclusion for the new AASB Standard should only apply to items that are not present obligations);
 - (b) it refers to social benefits. As noted in paragraph 28, defining the scope exclusion in terms of ‘social benefits’ would be likely to be problematic; and
 - (c) it is restricted to promises to provide benefits in non-exchange transactions. AASB staff disagree with basing the scope exclusion on non-exchange transactions, for the reasons set out in paragraph 29.

Recapitulation of AASB staff's conclusions

33. For the reasons discussed above, AASB staff think that:
- (a) the AASB's scope exclusion should not use the wording of the corresponding New Zealand scope exclusion;
 - (b) Approach 1, under which the scope exclusion would apply to 'announced intentions to sacrifice resources embodying economic benefits, in the form of a local government's or government's existing public policies, budget policies, election promises or statements of intent, that the entity presently has the discretion to avoid', would be consistent with the Aus paragraphs in AASB 137. Whether Approach 1 is the ideal approach to this issue is discussed in paragraphs 38 – 41; and
 - (c) none of the other candidate notions for the scope exclusion discussed in paragraphs 20 and 25 – 32 would meet the objectives for the scope exclusion set out in paragraph 5.

Approach 1A

34. As noted in paragraph 23, for the FRSB's May 2010 meeting, FRSB staff proposed a similar but extended form of the scope exclusion in Approach 1. It is called 'Approach 1A' in this staff paper. Although the FRSB decided to retain the existing New Zealand scope exclusion virtually unamended (and therefore rejected the FRSB staff proposal), it did so to ensure practice is unchanged under the Standard replacing NZ IAS 37, and not because it necessarily disagreed with the FRSB staff's proposed wording. Therefore, it seems appropriate to consider whether the FRSB staff proposal—or parts thereof—would represent an improvement on Approach 1. This is discussed below.

35. The FRSB staff proposed that “The Standard does not apply to:
- (a) the anticipated costs of future funding intentions of public benefit entities such as those expressed in legislation, government existing public policy, budget policy, statements of intent, special purpose reports, forecast financial plans of local authorities or similar; or
 - (b) any items expressed solely in general terms which includes qualitative statements about the anticipated costs of future funding intentions of a public benefit entity such as those made in election promise(s) or similar.”
36. The AASB staff’s views on the differences between that draft scope exclusion (Approach 1A) and Approach 1 are:
- (a) it is preferable to refer to sacrifices of resources embodying economic benefits (as per Approach 1), rather than to anticipated costs, because:
 - 1. the expression in Approach 1 is based on the *Framework* definition of a liability, which is referred to in the Working Draft IFRS *Liabilities*; and
 - 2. references to ‘costs’ are ambiguous, because ‘costs’ can be interpreted as expenditures or expenses. If a liability were recognised in respect of an item, the expense would be recognised as at an earlier date than the date of the expenditure;
 - (b) it is preferable not to refer to ‘funding intentions’ (as per Approach 1A), because that expression connotes funding of other entities rather than expenditure by the reporting entity on own-purpose programmes—the Aus paragraphs in AASB 137 cover both;
 - (c) the reference to ‘intentions ... expressed in legislation’ in Approach 1A would be a useful addition to Approach 1;
 - (d) the reference to ‘intentions expressed in ... special purpose reports (and) forecast financial plans’, which appears in Approach 1A, would seem

redundant because it is encompassed by the reference (in both Approaches) to ‘statements of intent’;

- (e) part 1 of Approach 1A would potentially scope out announced future funding intentions that the entity is presently obligated to honour—if this occurred, it would be inappropriate;
- (f) the reference in part 2 of Approach 1A to excluding ‘items expressed solely in general terms’ would seem redundant because:

1. the Working Draft IFRS *Liabilities* says, in respect of any entity, that a constructive obligation exists only if the entity has indicated that it will accept specific responsibilities (paragraph 12); and
2. it appears to be encompassed by part 1 of Approach 1A.

37. Therefore, AASB staff think the only modification to Approach 1 that would be warranted in the light of Approach 1A would be to add a reference to intentions expressed in legislation. Because the purpose of this staff paper is to discuss principles, not editorial matters, for the purpose of the following discussion and the questions to Board members, only Approach 1 is referred to (and such reference should be read to potentially include the above-mentioned addition).

Choice between Approach 1 and retaining the guidance in the existing Aus paragraphs

38. As mentioned in paragraph 33, Approach 1 is the only form of scope exclusion that the AASB staff considers could meet the objectives of the scope exclusion set out in paragraph 5. This section of the paper discusses whether Approach 1 is preferable to carrying forward to the new Standard the guidance in paragraphs Aus26.1 and Aus26.2 of AASB 137 (amended only to the extent necessary to accommodate changes between IAS 37 and its replacement IFRS). That carry forward is referred to below as Approach 2.
39. As mentioned in paragraph 24, AASB staff consider that the scope exclusion in Approach 1 would accurately describe the items to be excluded from the new Standard (i.e., it would exclude the items that the Aus paragraphs in AASB 137 indicate would not be treated as liabilities), and would be principle-based. However,

without supporting guidance, it may be unclear to readers of the Standard which announced intentions the entity presently has the discretion to avoid. If that guidance were not retained in some form, the risk arises of reopening the unresolved debate about which social benefit promises a public sector entity has the discretion to avoid. Providing detailed guidance on a scope exclusion would in substance be the same as retaining the detailed guidance presently set out in the two Aus paragraphs in AASB 137.

40. Another problem with Approach 1 is that announced intentions that the entity presently has the discretion to avoid are clearly not liabilities. Because the subject matter of the new Standard would be liabilities, it would seem unusual to explicitly scope out items that could not belong within the Standard's scope.
41. In view of the concerns noted in paragraphs 39 – 40, and the FRSB's decision to retain virtually unamended its existing PBE/NFP-specific modification, the AASB staff recommends that the AASB carries forward to the Standard replacing AASB 137 the guidance in paragraphs Aus26.1 and Aus26.2 of AASB 137, virtually unamended.

Question 1

- (a) Do Board members agree with the staff recommendation to carry forward to the Standard replacing AASB 137 the guidance in paragraphs Aus26.1 and Aus26.2 of AASB 137, virtually unamended (rather than replacing that guidance with a scope exclusion)?
- (b) If Board members disagree with that recommendation, do you support the scope exclusion presented as Approach 1, or would you support another principle for a scope exclusion? If the latter applies, please indicate the principle you would support.

Due process for making the PBE/NFP-specific modification

42. FRSB staff have indicated that, as a consequence of deciding to retain virtually unamended the current New Zealand PBE/NFP-specific modification, the FRSB does not intend to expose for public comment the wording of that modification before it is made to the new IFRS *Liabilities*.

43. AASB members are asked to consider whether the Board's intended PBE/NFP-specific modification for the AASB Standard incorporating the new IFRS should be exposed for public comment.
44. AASB staff think that, if the Board decides to carry forward the guidance in paragraphs Aus26.1 and Aus26.2 of AASB 137, virtually unamended, there is no need to expose that decision for comment, because relocating the same guidance does not create any substantive issues for the Board's constituents.
45. In addition, AASB staff think that, if the Board decides to replace the Aus paragraphs in AASB 137 with a scope exclusion in the replacement Standard for AASB 137, it would be unnecessary to expose the scope exclusion for public comment. This is because the scope exclusion would not be intended to result in any significant change to current practice.

Question 2

Do Board members agree that it is unnecessary to expose for public comment the PBE/NFP-specific modification?

APPENDIX A

Text of paragraphs Aus26.1 and Aus26.2 of AASB 137

Obligations arising from local government or government existing public policies, budget policies, election promises or statements of intent

- Aus26.1 This paragraph and paragraph Aus26.2 relate to the recognition by a local government, government department or government of a liability arising from a local government or government existing public policy, budget policy, election promise or statement of intent. The intention to make payments to other parties, whether advised in the form of a local government or government budget policy, election promise or statement of intent, does not of itself create a present obligation which is binding. A liability would be recognised only when the entity is committed in the sense that it has little or no discretion to avoid the sacrifice of future economic benefits. For example, a government does not have a present obligation to sacrifice future economic benefits for social welfare payments that might arise in future reporting periods. A present obligation for social welfare payments arises only when entitlement conditions are satisfied for payment during a particular payment period. Similarly, a government does not have a present obligation to sacrifice future economic benefits under multi-year public policy agreements until the grantee meets conditions such as grant eligibility criteria, or has provided the services or facilities required under the grant agreement. In such cases, only amounts outstanding in relation to current or previous periods satisfy the definition of liabilities.
- Aus26.2 Some such transactions or events may give rise to legal, social, political or economic consequences which leave little, if any, discretion to avoid a sacrifice of future economic benefits. In such circumstances, the definition of a liability is satisfied. An example of such an event is the occurrence of a disaster, where a government has a clear and formal policy to provide financial aid to victims of such disasters. In this circumstance, the government has little discretion to avoid the sacrifice of future economic benefits. However, the liability is recognised only when the amount of financial aid to be provided can be measured reliably.

APPENDIX B

Current New Zealand PBE/NFP-specific modification in NZ IAS 37

NZ 1.1. This Standard shall be applied by all entities in accounting for provisions, contingent liabilities and contingent assets except in the case of the Crown. In the case of the Crown this Standard shall not be applied in accounting for obligations expressed in legislation that have characteristics similar to an executory contract.

NZ 3.1. Obligations of the Crown expressed in legislation that have characteristics similar to an executory contract are those where:

- (a) the Crown is obligated to provide goods, services or transfers to the community in future periods using funding to be obtained from the community substantially in those future periods; and
- (b) the intended third party recipients of the goods, services or transfers have not yet satisfied the criteria for entitlement to those goods, services or transfers.

NZ 3.2. These obligations of the Crown have characteristics similar to executory contracts in that the community will, collectively, provide funds to the Crown in the future under tax legislation, and the Crown will, in return, provide goods, services or transfers to the community in the future. Such obligations of the Crown include obligations to make future social welfare payments (such as to pay unemployment, domestic purposes and national superannuation benefits) and to deliver future health and education services, to the extent that the substantial funding of those benefits will be met through future taxation and other revenues and the intended recipients have not already satisfied the criteria for entitlement to those benefits. However, such obligations exclude the obligation of the Crown to fund future payments by the Government Superannuation Fund since the recipients of those future payments have already performed services giving rise to obligations.

NZ 3.3. The exclusion from the application of this Standard of obligations of the Crown that have characteristics similar to an executory contract is not intended to achieve a different result, in terms of the Crown's recognition of liabilities, from the practice followed at the date of introduction of this Standard to recognise liabilities only where the recipients of benefits to be provided in the future have already satisfied the criteria for entitlement to those benefits. These obligations raise issues for financial reporting that require further study. Therefore, until further progress has been made in this regard, such obligations of the Crown are excluded from the scope of this Standard.