



Australian Government
Department of Finance and Deregulation

Reference: RMS12/05883
Contact: Veronique Row
Telephone: 02 6215 2104
e-mail: Veronique.row@finance.gov.au

Kevin Stevenson
Chairman
Australian Accounting Standards Board
Level 7
600 Bourke Street
Melbourne Vic 3000

Dear Mr Stevenson

Clarification of the Intent of Aus Paragraph 26.2 of AASB 137 Provisions, Contingent Liabilities and Contingent Assets

I am writing to seek clarification from the Australian Accounting Standards Board on the intent of paragraph Aus 26.2 of AASB 137 *Provisions, Contingent Liabilities and Contingent assets* (Aus 26.2).

Paragraph Aus 26.1 of AASB 137 (Aus 26.1) states that intentions to make payments to other parties do not create present obligations that are binding; for example multi-year grant agreements do not create a present obligation until the grant recipient has met conditions such as eligibility requirements.

In addition, Aus 26.2 indicates that a government should recognise a liability when events give rise to consequences which leave little, if any, discretion for the entity to avoid a sacrifice of future economic benefits. As an example of such an event that would create a liability, the paragraph uses the occurrence of a natural disaster where a government has a policy to provide financial aid to victims of the disaster and the amount of the aid can be reliably measured.

In developing Aus 26.1 and Aus 26.2, was the Board's intention that the use of the natural disaster example:

- illustrate the principles contained in these paragraphs; or
- establish a principle that all natural disasters occurring would create a present obligation for a government that has a disaster assistance policy, without further considering the particular conditions to be met for a present obligation?

This ambiguity has caused confusion among preparers of financial reports and led to divergent views between auditors and preparers and between government jurisdictions in

determining the expense recognition points, specifically in the cited example of natural disasters.

As it stands, there appear to be currently two possible interpretations of the disaster example in Aus 26.2, either:

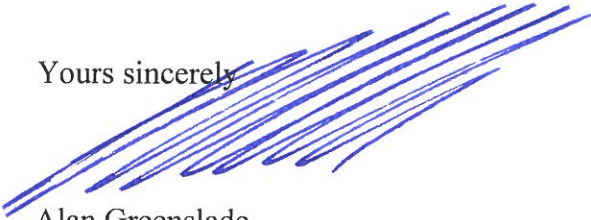
- Aus 26.1 and Aus 26.2 are intended to clarify application to non-exchange transactions, but otherwise represent no change to the principles throughout AASB 137 in respect of issues such as present obligations; or
- that natural disasters are a unique circumstance, and it is a requirement that the occurrence of a disaster would require a government to report a liability, without further consideration as to whether there is a present obligation at that time.

Historically, the Australian Government has adopted the first interpretation, recognising obligations for natural disasters on the same basis as other grants when the recipient has met the eligibility criteria. However, divergent views arose in relation to advanced payments the Commonwealth made to State governments in the wake of major floods affecting Australia in 2011 under the National Disaster Relief and Recovery Arrangements (NDRRA). Under NDRRA, the Commonwealth assistance is available to reimburse States for expenditure on eligible disasters. We appreciate that it is inappropriate to ask about these individual circumstances, and instead are seeking your views on the intended principles. However, we would be more than happy to provide further detail of the specific issue if requested.

Proponents of the first interpretation of Aus 26.2 determined that no liability arose for the Australian Government on occurrence of the disaster as it would not have an unconditional obligation until the States incurred expenditure eligible for reimbursement, meeting the eligibility criteria principle of Aus 26.1. Advocates for the second interpretation determined that on the occurrence of the disaster a constructive obligation was created and a liability should be recognised by the Australian Government at that point.

It is important the intent of this paragraph be resolved as confusion over the application of these principles could potentially result in uncertainty in the timing of liability recognition for other grants of uncertain timing or amount that falls within the ambit of AASB 137. Different interpretations of Aus 26.2 could lead to the same or similar transactions being accounted for in different ways by different governments, raising comparability issues.

Yours sincerely



Alan Greenslade
First Assistant Secretary
Financial Reporting & Cash Management
Department of Finance and Deregulation

18 June 2013



Australian Government
Australian Accounting
Standards Board

AASB 17-18 July 2013
Agenda paper 3.7 (M132) - tabled

Level 7, 600 Bourke Street
MELBOURNE VIC 3000
Postal Address
PO Box 204
Collins Street West VIC 8007
Telephone: (03) 9617 7600
Facsimile: (03) 9617 7608

4 July 2013

Alan Greenslade
First Assistant Secretary
Financial Reporting & Cash Management
Department of Finance and Deregulation
John Gorton Building
King Edward Terrace
Parkes ACT 2600

Dear Mr Greenslade

Clarification of the Intent of Aus Paragraph 26.2 of AASB 137
Provisions, Contingent Liabilities and Contingent Assets

Thank you for your letter dated 18 June 2013 regarding the above-named subject. Please note this response reflects personal observations and views based on the information you provided and suggests factors to consider, rather than answers. This response does not necessarily represent the views of the AASB; AASB views are set out in Board pronouncements developed through a full due process.

Regarding your question about the background to paragraphs Aus26.1 and Aus26.2 of AASB 137, paragraphs BC25 and BC26 of the AASB's Basis for Conclusions on *AASB 2007-9 Amendments to Australian Accounting Standards arising from the Review of AASs 27, 29 and 31* indicate that these paragraphs were relocated, substantially unamended, from AAS 31 *Financial Reporting by Governments* when AAS 31 was withdrawn and appropriate components of that Standard were subsumed into other Australian Accounting Standards. Paragraph BC26 noted that the inclusion of those paragraphs in AASB 137 was not intended to change the recognition practices followed by public sector entities in relation to obligations arising from local government and government existing public policies, budget policies, election promises or statements of intent. Paragraph BC26 went on to note that these obligations raise financial reporting issues that require further research.

Paragraph Aus26.2 of AASB 137 gives an example of a liability arising upon the occurrence of a disaster "where a government has a clear and formal policy to provide financial aid to victims of such disasters". The implications of that guidance would depend, to a significant extent, on the interpretation of its reference to a 'clear and formal policy'. Whether (and when) a clear and formal policy to provide particular financial aid exists would depend on the circumstances. For example, different conclusions might be reached about whether a present obligation exists according to whether, for a particular type of disaster, a government's financial assistance transfers are either a matter for negotiation on a case-by-case basis or fall within a pre-existing formal framework with another party (e.g. a State Government) that binds the transferor government before, for example, eligible expenditures are made.

It would seem that paragraph Aus26.2 of AASB 137 could appropriately be applied without reference to the guidance in paragraph Aus26.1 of that Standard. That is, the reference in

paragraph Aus26.1 to not having a present obligation until beneficiaries meet eligibility criteria would not necessarily be relevant to the disaster aid example in paragraph Aus26.2. A present obligation to provide disaster aid could arise before aid recipients (whether members of the community or other governments receiving aid on their behalf) meet particular eligibility criteria, if a clear and formal policy exists to provide that aid and effectively binds the government upon the occurrence of the disaster.

In addition, as paragraph Aus 26.2 notes, recognition of a liability (provision) to provide aid would not occur until the amount of the aid to be provided can be measured reliably.

Regarding the bullet points on page 2 of your letter, my comments are, respectively:

- paragraphs Aus26.1 and Aus26.2 of AASB 137 are not formally limited in scope to non-exchange transactions, although the transactions they refer to would tend to be non-exchange in nature. In other words, the treatment of transactions described in those paragraphs does not differ according to whether a future transfer would occur in, or arise from, a non-exchange transaction; and
- my view of the guidance in paragraph Aus26.2 of AASB 137 is that it is an example of applying the principles in AASB 137 regarding when a present obligation exists, and was not intended to override those general principles as a 'unique case'. This means, in my view, that a 'clear and formal policy' to provide financial aid (referred to above) should be interpreted in a manner consistent with the general principles (particularly that, as indicated in the definition of an 'obligating event' in paragraph 10 of AASB 137, the government must have a legal or constructive obligation and no realistic alternative to settling that obligation).

I trust these comments are of assistance. If you have any questions about this letter, please do not hesitate to contact me or Jim Paul (jpaul@asb.gov.au).

Yours sincerely,



Kevin M. Stevenson
Chairman and CEO