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From: David Maxwell [mailto:davemax@ozemail.com.au]
Sent: Friday, 9 September 2005 4:14 PM
To: standard@aasb.com.au
Subject: Exposure draft 140

Dear Sir,

We submit the following comments on the contents of ED 140.

Constructive Obligations
Our immediate impression on reviewing the wording "... created a valid expectation in those parties that they can reasonably rely on ..." is that it is rather more tautological than restrictive, and to that extent we support the AASB's preliminary view.

Measurement of Liabilities
We interpret the basic thrust as first determining whether a present obligation exists - in which case the entity has a liability and a measurement problem.
It appears that the probability component only enters into the measurement process - see example 17.
In general, we are comfortable with this approach.

However, we are not comfortable with any accounting standard where it is necessary to state that a permitted measurement method is incompatible with that standard's measurement objective. Further, the standard gives inadequate guidance as to the circumstances when either approach is preferred, the factors to be taken into account in determining to change the approach, and whether such a change constitutes a change in accounting policy.
(An entity usually manufactures 1 ultra-large widget in a year, and normally measures its warranty liability on the "most probable outcome" basis. In the year when it manufactures 2 widgets, is it required to adopt the "sum of probabilities" approach?)

We also accept the AASB preliminary view in relation to the two different measurement bases in paragraph 29 of the draft standard.

Contingent Liabilities
In relation to what we have previously regarded as "contingent liabilities", the examples suggest that once legal action against the company is commenced, a liability will ALWAYS exist - the obligation to stand ready to perform as the court directs.

Which leaves the measurement problem..... Possibly the principle of prudence would require us to assume that there is always a minimum 10% chance of losing any case - the judge may have dyspepsia ;-) - and hence the minimum measurement would be the discounted cash flow value of 10% of the potential payout. Perhaps this is to overstate the situation, but we see the potential for recognition of significantly large amounts that would previously have been disclosed as contingent, and hence not recognised. We found examples 1 & 17 of particular benefit.

Present Value
We suggest that the Australian equivalent version of the standard should give guidance in relation to the discount rate applicable for NFPs. Our view is that, for local government entities at least, that rate should be

market yields on government bonds.

Derecognition
We suggest that there could be additional guidance given in relation to paragraph 51 of the standard. For example, a statute-barred debt has neither been settled, cancelled or expired. It still exists, but the creditor (with instances where a court has found otherwise) cannot sue to recover the debt. Example 13(b) refers to "a non-financial liability ... recognised for the obligation to pay fines and penalties" which certainly exists, but the assessment of the probability of the outflow from the entity of resources embodying economic benefits will be materially affected by the date of the next inspectorial visit, and the inspector's ability to commence the prosecution before the statutory period expires.

It could be that the probability of the outflow of economic benefits abates to below materiality thresholds, but there are many instances in the local government industry where such guidance would be of assistance. (e.g. Assets left in trust to the local government for a particular purpose where the donor and connections have either deceased or left the district, in some instances well over 50 years ago.)

Dissenting Member's Views
We have reviewed the views set out on page 104 & 105 of the IASB draft, and respectfully advise that we concur with the majority view.

We shall be pleased to supply any further information that you may require.

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