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Mr Henry Rees
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International Accounting Standards Board
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UNITED KINGDOM

Email: commentletters@iasb.org

Dear Henry

Re: Exposure Draft of Proposed Amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets and IAS 19 Employee Benefits

We appreciate the opportunity to comment on the Exposure Draft of Proposed Amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 19 *Employee Benefits*. Our comments have been prepared in consultation with members through our Asia-Pacific Financial Reporting Advisory Group (APFRAG) which is a board committee representing a regional perspective from South-East Asia, Oceania and Australasia.

Overall we are in agreement with the proposals. However, as a general comment, we would have preferred that the IASB and FASB expose the changes to the Framework before making consequential changes to IFRS. Our members have concerns that changes in the Framework which may have been recommended and not yet finalised, may necessitate further revision of IFRS and hence cause confusion for preparers and users of financial reports.

Our detailed comments are attached to this letter.

Should you have any queries on our comments, please contact Ms Sepi Roshan, CPA Australia's Financial Reporting and Governance Policy Adviser, at email: sepi.roshan@cpaaustralia.com.au

Yours sincerely

A handwritten signature in black ink, appearing to read 'Peter Lowe', written over a white background.

Peter Lowe CPA
Chief Executive

cc: Sepi Roshan
David Boymat

Proposed Amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets

Question 1 – Scope of IAS 37 and terminology

(a) Do you agree that IAS 37 should be applied in accounting for all non-financial liabilities that are not within the scope of other Standards? If not, for which type of liabilities do you regard its requirements as inappropriate and why?

Our view is that the Framework¹ will help determine whether a liability exists. If a liability does exist, then the accounting standards will help determine how to measure and disclose information about this liability. As such, we are also of the understanding that once the definition and recognition criteria of a liability are met and it can be determined that it is a non-financial liability, it will fall within the scope of Draft IAS 37.

We believe that it is fundamental to focus on the Framework as a starting point for identifying the elements of financial statements. The measurement and disclosure of elements identified should then be made with reference to the appropriate standard(s). Specifically, the Framework states that the “definitions of an asset and a liability identify their essential features but do not attempt to specify the criteria that need to be met before they are recognised in the balance sheet” (paragraph 50).

Therefore, to encourage the appropriate measurement and disclosure of elements of financial statements identified under the Framework, we agree that there should be a standard dealing with all non-financial liabilities that are not within the scope of other standards.

(b) Do you agree with not using ‘provision’ as a defined term? If not, why not?

We also agree that the concept of non-financial liabilities should not be restricted to “provisions”. We encourage the removal of the term “provision” to avoid confusion with the common use of the term as adjustments to assets movements (eg provision for depreciation, provision for doubtful debts).

Question 2 – Contingent liabilities

(a) Do you agree with eliminating the term ‘contingent liability’? If not, why not?

Once a liability is identified under the Framework and is within the scope of Draft IAS 37, it is considered an unconditional obligation. Any uncertainties (conditions or contingencies) which exist in regards to this unconditional obligation will be reflected in the measurement of the non-financial liability. As such, we agree that the term “contingent liability” be removed.

We do not see the need for a special class for “possible obligations”. We see this as analogous with the concepts in paragraph 52 regarding future operating losses.

We are concerned however, about the treatment of non-financial liabilities that cannot be reliably measured. Paragraph 27 argues that “[e]xcept in extremely rare cases, an entity will be able to determine a reliable estimate” and where uncertainties exist, paragraph 68 requires certain disclosures. As such uncertainties regarding obligations will still need to be disclosed we are comfortable if the term “contingent liability” is no longer used.

While we are in agreement with the changes, our members have raised concerns that changes in terminology may confuse preparers and users of financial reports.

¹ We understand that the IASB is currently undertaking a review of the Framework, in its convergence project with the FASB. As such, we base our views on the current Framework.

(b) Do you agree that when the amount that will be required to settle a liability (unconditional obligation) is contingent on the occurrence or non-occurrence of one or more uncertain future events, the liability should be recognised independently of the probability that the uncertain future event(s) will occur (or fail to occur)? If not, why not?

The probability of meeting the definition and recognition criteria of liability in the Framework should be considered separately from the probability of settlement, which is based on conditions which must first be met. However, we suggest that this concept be more clearly explained. For example, we suggest the following two step approach be provided as guidance:

- (i) does the item meet the definition and recognition criteria of liability in the Framework (recognition of unconditional liability); and
- (ii) apply measurement and disclosure requirements per appropriate financial reporting standard. If the liability is a non-financial liability, then its measurement incorporates the related probability of any uncertain future events (conditional obligation).

This two step approach clearly identifies the Framework as being the precursor to any other requirements.

Question 3 – Contingent assets

(a) Do you agree with eliminating the term ‘contingent asset’? If not, why not?

Based on the same arguments in question 2, we agree with eliminating the term “contingent asset”.

(b) Do you agree that items previously described as contingent assets that satisfy the definition of an asset should be within the scope of IAS 38? If not, why not?

We do not agree that items previously described as contingent assets should be accounted for under IAS 38. Under the current IAS 37, a “contingent asset” is defined as a “possible asset”, not the right to an asset. Based on our arguments above and the premise of the draft Standard, any conditions relating to the settlement receipt of such an asset should be considered a measurement issue. The asset in question would not necessarily be an intangible asset (ie: an identifiable non-monetary asset without physical substances). We could accept that if the “right” to such an asset is separable from the underlying asset or arises from contractual or other legal rights, then that “right” might be considered an intangible asset – but not the asset itself.

Given the lack of focus on non-financial assets within the Draft IAS 37 we suggest that the IASB develop a catch-all standard dealing with non-financial assets, based on the same arguments and concepts put forward for non-financial liabilities.

Question 4 – Constructive obligations

(a) Do you agree with the proposed amendment to the definition of a constructive obligation? If not, why not? How would you define one and why?

We agree with the focus on “past events” in the definition of a “constructive obligation” as it is consistent with the Framework’s identification of the elements of financial statements.

(b) Is the additional guidance for determining whether an entity has incurred a constructive obligation appropriate and helpful? If not, why not? Is it sufficient? If not, what other guidance should be provided?

We agree that guidance and examples should be provided in helping an entity determine whether they have a constructive obligation and we suggest that more guidance be provided.

For example, a direct quote from the Framework would help conceptualise the notion of constructive obligations, as distinct from legally binding contracts. As such, we suggest the following wording for paragraph 15:

“While legally enforceable obligations can generally be identified more easily, constructive obligations are a matter of the substance of each agreement. Such obligations can arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner (underlined quoted from Framework, paragraph 60). Therefore, ~~in~~ in the absence of legal enforceability, particular care is required.....”

Under previous Australian GAAP, a constructive obligation was described as one “created, inferred, or construed from the facts in a particular situation rather than contracted by agreement with another entity or imposed by government” (Conceptual Framework – Statement of Accounting Concepts 4: *Definition and Recognition of the Elements of Financial Statements* (paragraph 56)).

Question 5 – Probability recognition criterion

Do you agree with the analysis of the probability recognition criterion and, therefore, with the reasons for omitting it from the Standard? If not, how would you apply the probability recognition criterion to examples such as product warranties, written options and other unconditional obligations that incorporate conditional obligations?

Draft IAS 37 is intended to apply to non-financial liabilities that meet the definition and recognition criteria of liability in the Framework. As such, we agree that the probability criteria be omitted, but only if it is made clearer that the Framework requirements must be met before the application of Draft IAS 37 requirements (for example, guidance in the form of a suggested two step approach – see question 2(b)).

We therefore suggest that it be made very clear that Draft IAS 37 requirements are only applied where a liability exists under the Framework and is not within the scope of another standard.

We understand that the IASB is currently undertaking a review of the Framework, in its convergence project with the FASB. As such, we base our views on the current Framework assuming that the concepts, to a large degree, will remain unchanged. We would prefer wider debate regarding any changes to the Framework, which will be brought into other standards.

Question 6 – Measurement

Do you agree with the proposed amendments to the measurement requirements? If not, why not? What measurement would you propose and why?

We agree that a non-financial liability be measured at the amount that an entity would rationally pay settle or transfer to a third party. Draft IAS 37 relies on the “best estimate” approach and as such, implicitly assumes that an entity is able to measure the uncertainty and risk surrounding settlement. We believe that the proposed approach better measures the risk of having such an obligation and hence represents the measurable economic burden of such an obligation, taking into consideration the probabilities of the outcomes of various conditions. As such, the expected probable, risk-adjusted cash outflows approach proposed may more accurately measure the obligation as at balance date.

Question 7 – Reimbursements

Do you agree with the proposed amendment to the recognition requirements for reimbursements? If not, why not? What recognition requirements would you propose and why?

We agree that the underlying asset (ie: reimbursement) meets the definition of an asset. However, to clarify the requirements in Draft IAS 37, we suggest that the term “reimbursement right” be changed to just “reimbursement”. For consistency, this should also be the case in Draft IAS 19.104A.

Notwithstanding the above, while we do agree that the reimbursement should be recognised as an asset, we suggest that IAS 37 provide guidance as to what type of asset would be appropriate. For example, the “right” to reimbursement might be recognised as an intangible asset under IAS 38 or as an embedded derivative under IAS 39. Guidance as to what asset it may or may not be recognised, can help to minimise divergent and/or unacceptable practice.

Question 8 – Onerous contracts

(a) Do you agree with the proposed amendment that a liability for a contract that becomes onerous as a result of the entity’s own actions should be recognised only when the entity has taken that action? If not, when should it be recognised and why?

We agree as the entity’s action is the past event, as required by the Framework, which establishes an obligation.

(b) Do you agree with the additional guidance for clarifying the measurement of a liability for an onerous operating lease? If not, why not? How would you measure the liability?

We support any additional guidance that provides clarity and aims to prevent divergent and/or unacceptable practices.

However, we question why in paragraph 58, the unavoidable costs must reflect the “least net cost of exiting from the contract”. We would expect that the unavoidable costs be those which can be reasonably expected to be paid based on the actual contract and foreseeable estimated cash flows, rather than considering a best estimate of settlement. As such, we suggest that the measurement in paragraph 58 represent the minimum which must be recognised.

We question why the avoidable costs under an operating lease be measured as the remaining lease payments less estimated sublease rentals that could be reasonably obtained, “even if the entity does not intend to enter into a sublease”. Similar to the measurement requirements for conditional obligations, we would expect that any subleasing amounts be deducted from the expected cash outflows, weighted by their probability, until they are known with certainty.

(c) If you do not agree, would you be prepared to accept the amendments to achieve convergence?

Overall, we believe that convergence should produce a single set of high quality global accounting standards. As such, we are in agreement with the IASB that the aim of convergence is to build on existing best practice within all GAAP. The current Framework aims for the fair presentation of the financial position, performance and changes in financial position of an entity (Framework paragraph 46). Therefore, we believe that to accept accounting practices purely to achieve convergence, regardless of other factors, is not in the best interests of convergence.

However, we do accept that a case-by-case review be undertaken to determine whether such amendments would hinder the objective of convergence, given the complexities faced. In this instance, we can see the benefits of convergence.

Question 9 – Restructuring provisions

(a) Do you agree that a liability for each cost associated with a restructuring should be recognised when the entity has a liability for that cost, in contrast to the current approach of recognising at a specified point a single liability for all of the costs associated with the restructuring? If not, why not?

We believe that a liability should be recognised when it meets the definition and recognition criteria in the Framework. This liability is then measured according to the appropriate financial reporting standard which will apply (eg Draft IAS 37 for non-financial liabilities).

Therefore, we suggest the following wording change for paragraph 61:

An entity shall recognise a non-financial liability for a cost associated with a restructuring only when the definition **and recognition criteria** of a liability **have** been satisfied **according to the Framework**

We suggest this specific wording as the Framework specifically states that the “definitions of an asset and a liability identify their essential features but do not attempt to specify the criteria that need to be met before they are recognised in the balance sheet” (paragraph 50). This would also acknowledge that there is a point within a restructuring program at which a constructive obligation is owed which would give rise to an obligation (refer to our comments in question 4).

(b) Is the guidance for applying the Standard’s principles to costs associated with a restructuring appropriate? If not, why not? Is it sufficient? If not, what other guidance should be added?

We support any additional guidance that provides clarity and aims to prevent divergent and/or unacceptable practices. To enhance this guidance, we suggest that a definition of “restructuring” is added to provide a context. The current IAS 37 provides a definition which may still be appropriate.

Other comments

Please find our other comments regarding the proposed Amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Name of IAS 37

Based on the requirements of the proposed IAS 37, we suggest that a more reflective name be used. We suggest the following name may be appropriate “Accounting for Non-financial Liabilities”.

Reference to non-financial assets

As suggested in our response to question 3(b), we believe that it would be beneficial if the IASB develop a catch-all standard dealing with non-financial assets, based on the same arguments and concepts put forward for non-financial liabilities.

The lack of focus on non-financial assets within the Draft IAS 37 has prompted our response.

Reference to Framework

To emphasise the importance of and reliance on the Framework in determining which liabilities and assets fall within the scope of IAS 37, we suggest the following paragraph be added to the scope section:

"This standard applies to liabilities and assets:

- (a) which meet the definition and recognition criteria of liabilities and assets in the Framework; and*
- (b) are not within the scope of other Standards"*

Paragraph 68

CPA Australia believes that the information in subparagraphs (a), (b) and (d) should be disclosed for all liabilities rather than only for those with estimation uncertainty as currently required. The requirements in (c) could become a separate disclosure requirement which deals specifically with uncertainties.

Paragraph 71

We have concerns that the requirements in paragraph 71 may be seen as a loophole by some entities that wish to avoid disclosing the information in paragraphs 68 and 69. Our concern is raised because there is no definition of "extremely rare". We suggest that the IASB clarify what it means by "extremely rare" by providing a definition and/or examples.

References to non-financial liabilities

Just an editorial matter of note. We have noticed instances where the term "non-financial liability" has not been used in the IG examples.

Proposed Amendments to IAS 19 Employee Benefits

Question 1 – Definition of termination benefits

The Exposure Draft proposes amending the definition of termination benefits to clarify that benefits that are offered in exchange for an employee's decision to accept voluntary termination of employment are termination benefits only if they are offered for a short period (see paragraph 7). Other employee benefits that are offered to encourage employees to leave service before normal retirement date are post-employment benefits (see paragraph 135).

Do you agree with this amendment? If not, how would you characterise such benefits, and why?

We agree with the definition of "termination benefits" but would like a clear definition of "short period". There is confusion as to whether this "short period" is the "minimum retention period" or another period of time. For example, in some jurisdictions, conventionally a short period represents approximately three months and twelve months in others. We would prefer that this be stipulated to provide clarity and so that divergent and/or unacceptable practices can be prevented.

Question 2 – Recognition of termination benefits

The Exposure Draft proposes that voluntary termination benefits should be recognised when employees accept the entity's offer of those benefits (see paragraph 137). It also proposes that involuntary termination benefits, with the exception of those provided in exchange for employees' future services, should be recognised when the entity has communicated its plan of termination to the affected employees and the plan meets specified criteria (see paragraph 138).

Is recognition of a liability for voluntary and involuntary termination benefits at these points appropriate? If not, when should they be recognised and why?

We believe that a liability should be recognised when it meets the definition and recognition criteria in the Framework. Based on our understanding of Draft IAS 37.64, termination costs are considered onerous contracts.

We agree that in regards to voluntary termination, the past event that gives rise to an obligation for an entity is the acceptance of the termination payment by the employee.

We accept that the past event or transaction that gives rise to involuntary termination payments is when the plans are communicated to the affected employees. However, we suggest that a liability be recognised even if it is not "unlikely that significant changes to the plan will be made or that the plan will be withdrawn" (Draft IAS 19.138). We accept that the decision by management to provide involuntary terminations does not in itself give rise to a liability. However, analogous to the proposals in Draft IAS 37, we believe that management's communication of involuntary terminations to employees (ie: when it takes action to implement its decisions) gives rise to an unconditional liability. The measurement of this liability will depend on the conditional obligation (eg: changes in plans) as per the requirements of Draft IAS 37.

It should be made clearer to whom the communication is required to be made. For example, Draft IAS 37.64 indicates that communication has to be made in writing to the employee concerned. However, Draft IAS 19.138 indicates a more general approach. We are concerned about this inconsistency as some constituents may interpret that the communication be made to a group of employees that could be affected (given that involuntary redundancies could potentially be anyone within a group, business unit or the like) or to specific individuals. One way to clarify this is to provide extra guidance in Draft IAS 19, such as provided in IAS 37.64 and/or to wording changes to Draft IAS 19.138.

In our experience, there has been some confusion as to who (ie individuals or groups of employees) must be communicated with in order for a liability to be recognised.

For example, if the termination benefits are required to be communicated to an individual (specific) employee, we suggest the following wording to Draft IAS 19.138:

- “Except as specified.....
- (a) identify the ~~number of~~ employees whose employment is to be terminated.....”
 - (b) establish the benefits that *that* employees will receive upon termination.....to enable *that* employees to determine.....”

Question 3 – Recognition of involuntary termination benefits that relate to future service

The Exposure Draft proposes that if involuntary termination benefits are provided in exchange for employees’ future services, the liability for those benefits should be recognised over the period of the future service (see paragraph 139). The Exposure Draft proposes three criteria for determining whether involuntary termination benefits are provided in exchange for future services (see paragraph 140).

Do you agree with the criteria for determining whether involuntary termination benefits are provided in exchange for future services? If not, why not and what criteria would you propose? In these cases, is recognition of a liability over the future service period appropriate? If not, when should it be recognised and why?

We believe that the three criteria are acceptable. We suggest that more emphasis be placed on the concept that involuntary termination payments are those that are incremental to what employees would otherwise receive for services, and that this incremental obligation is the liability, not total payment up until termination.

Therefore, we suggest the following wording be added to Draft IAS 19.7 (definition of “termination benefits”):

“The amount of termination benefits to be recognised as a liability shall be those amounts incremental to what the employee would otherwise be entitled”

