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ED 140 sub 3

New South Wales
TREASURY

Mr David Boymal
The Chairman
Australian Accounting Standards Board
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Contact: D McHugh
Telephone: (02) 9228 5340
Our Reference:
Your Reference:

Dear Mr Boymal

Exposure Draft ED 140 Proposed Amendments to AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* and AASB 119 *Employee Benefits*

I refer to Exposure Draft ED 140 of Proposed Amendments to AASB 137 and AASB 119. Detailed comments regarding the AASB's specific matters for comment, along with a copy of the submission to the IASB on its Invitation to Comment are attached.

As well as sharing many of the AASB's concerns regarding the IASB proposals, Treasury does not agree that entities can reliably measure liabilities, "except in extremely rare cases" (ED 140, para 27). In Treasury's view, many 'single' unconditional liabilities with contingencies will not be recognised as they cannot be reliably measured. Further, in Australia, additional guidance is required for the public sector, particularly regarding non-exchange social benefits. This clarification is required to limit any potential application of the IASB's concept of a 'stand-ready' unconditional obligation.

If you have any queries regarding these comments, please do not hesitate to contact me on 9228 3019.

Yours faithfully

Robert Williams

Robert Williams
for Secretary
22/9/05

AASB SPECIFIC MATTERS FOR COMMENT – ED 140

(a) Whether constituents support the Board's preliminary views and / or share the Board's concerns with the proposed amendments

For detailed responses, attached are Treasury's responses to the IASB's Invitation to Comment questions. In particular, NSW Treasury shares the AASB's concerns / comments regarding:

- Constructive obligations (refer response to Question 4);
- Probability recognition criterion (refer response to Question 5);
- Measurement (refer response to Question 6);
- Restructuring provisions (refer response to Question 9).

(b) Any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to not-for-profit and public sector entities.

Obligations to provide non-exchange social benefits

IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* includes additional commentary to clarify that the standard does not apply to provisions and contingent liabilities arising from 'non-exchange social benefits' such as social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of the goods and services provided directly in return from recipients of those benefits.

As previously commented (as part of the Heads of Treasuries Accounting and Reporting Advisory Committee submission on ED 127), Treasury believes that this additional commentary should be included in the Australian equivalent of IAS 37. Among other things, this will ensure that onerous contracts are correctly accounted for in the public sector. Onerous contracts are only relevant to reciprocal transactions. That is, where a public sector entity has contracted to provide social benefits by delivering health, education, transport and other social services to the community, such benefits cannot be regarded as an onerous contract. This is because the nature of the benefit is such that there is no expectation that the public sector entity will receive consideration approximately equal to the value of goods and services provided, from the recipients of those benefits (ie the community).

Alternatively, if this additional commentary is not included, Treasury believes that clarification along the lines suggested in Treasury's response to Question 5 of the IASB response should be included. That is, in Treasury's view, a general 'stand ready' unconditional obligation to make social benefit payments in *future* reporting periods does not exist, as there has been no past event.

In addition, if AAS 27, AAS 29 and AAS 31 are withdrawn, the guidance included in these Standards, could also be modified for inclusion in the amended AASB 137 (refer AAS 31, paras 12.1.2-12.1.3).

Recognition of liabilities under ED 125

The AASB should also review the implications of the proposed IAS 37 on the proposals in ED 125 *Financial Reporting by Local Governments* regarding liabilities arising from in-substance agreements to provide a good or service and other agreements. ED 125 does not adopt the same approach to conditions, as proposed in ED 140. ED 125 contemplates situations where conditional obligations give rise to a liability, while the proposed IAS 37 states that liabilities only arise from unconditional obligations.

(c) *Whether the proposals are in the best interests of the Australian economy.*

Yes, subject to the comments made in the attached submission.

(d) *Whether constituents support the removal of the probability threshold for non-financial liabilities accounted for under IAS 37, and if not, whether the removal of the probability threshold is supported for non-financial liabilities assumed in a business combination.*

Treasury supports the removal of the probability recognition criterion, at a conceptual level. However, in addition, we believe that this requires amendment to the *Framework* and IAS 38, for consistency. ED 140 creates additional difficulties associated with reliably measuring the future economic benefits. To address this, additional amendments and detailed guidance are required regarding the definition and measurement of unconditional obligations.

New South Wales
TREASURY

Mr Henry Rees
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Contact: R Williams
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Our Reference:
Your Reference:

Dear Mr Rees

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

I refer to the Exposure Draft of Proposed Amendments to IAS 37 and IAS 19. Detailed comments regarding the questions in the Invitation to Comment are attached.

New South Wales Treasury supports, at a conceptual level, the proposal to omit the probability recognition criterion. Currently, many unconditional obligations (eg warranties) are recognised because, although it might not be probable that a payment will arise from a single obligation, it is probable that some payment will arise in a "portfolio (or class) of similar obligations" (as acknowledged in the Exposure Draft, para BC39). But, the proposed amendments will substantially increase the scope of obligations that meet the proposed definition of liabilities in IAS 37, by including unconditional liabilities that meet the current definition of contingent liabilities.

However, in practice, the proposed definition is also likely to result in a commensurate increase in liabilities that are not recognised because they cannot be reliably measured. This increase in unrecognised liabilities is likely to represent single unconditional obligations that cannot be reliably measured. This is because, although there are known statistical methods to reliably measure a portfolio of similar obligations, there are no similar reliable measurement techniques for single obligations.

Put in other words, NSW Treasury does not agree with the unsupported assertion that entities can reliably measure liabilities, "except in extremely rare cases" (Exposure Draft, para 27). This assertion had validity under the current IAS 37 for probable obligations and individually improbable obligations valued on a portfolio basis. But, the assertion cannot be extended to individual obligations that are improbable or remote (currently not recognised but disclosed as contingencies or not disclosed respectively).

NSW Treasury's view is that it would undermine the reliability and credibility of financial statements if such liabilities were recognised as liabilities. Further, NSW Treasury's view is that it would be difficult to find a Board of Directors to sign a set of financial statements that included such liabilities.

NSW Treasury therefore recommends that para 27 be amended to acknowledge that, in many cases, it may not be possible to reliably measure unconditional liabilities that have a wide range of possible outcomes regarding potential outflows of economic benefits. Instead, such liabilities should be disclosed as "liabilities that cannot be measured reliably" (applying para 69).

Conversely, if the IASB believes that such liabilities can be reliably measured, NSW Treasury recommends that the IASB provides extensive, additional, detailed, practical guidance to demonstrate how such liabilities can be reliably measured.

Finally, if the definition is amended as proposed, NSW Treasury believes that extensive consequential amendments will be needed to the *Framework*, IAS 38, IAS 19 and other standards and interpretations to avoid any conflicts. Also, further amendments will be needed to IAS 37 to remove inconsistencies in the proposed treatment of constructive obligations and onerous contracts.

If you have any queries regarding NSW Treasury's comments, please do not hesitate to contact me on 612 9228 3019 or Dianne McHugh on 612 9228 5340.

Yours faithfully

Robert Williams

Robert Williams
for Secretary
22/9/05

INVITATION TO COMMENT – 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?

Yes. However, it is noted that some liabilities may meet the definition of financial liabilities, but are excluded from the scope of both IAS 32 and IAS 39 as they are addressed by other Standards. These include employee benefit obligations and insurance contracts. Therefore, while excluded from the scope of IAS 37, these are not examples of non-financial liabilities, as is stated in para 4.

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

Yes. However, Treasury also agrees with the proposed Standard that an entity should still be permitted to describe some classes of non-financial liabilities as 'provisions' in their financial statements (as para 9 allows).

Question 2 – Contingent liabilities

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

Yes. However, Treasury supports including a new term, 'liabilities with contingencies' and modifying para 69 of the proposed Standard to require disclosure of 'liabilities with contingencies' that cannot be measured reliably. This approach is consistent with the discussion on contingencies in paras 22-26 of the proposed Standard.

In Treasury's view, it is important that the term 'liabilities with contingencies' is used as the elimination of the term 'contingent liability' should not deny the significant uncertainties that will remain regarding the amount and timing of cash flows required to settle such liabilities. In Treasury's view, many 'single' unconditional liabilities with contingencies will not be recognised as they cannot be reliably measured. This is further discussed in the response to Question 6.

(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 events will occur (or fail to occur)? If not, why not?

Yes. However, as discussed in the response to Question 5 below, the Board will need to amend the Framework and other Standards, for any inconsistencies.

Question 3 – Contingent assets

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

Yes. However, for the same reasons discussed in the response to Question 2(a) above, Treasury supports including a new term, 'assets with contingencies' and making a consequential amendment to IAS 38, to require disclosure of 'assets with contingencies' that cannot be measured reliably.

(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?

Yes. However, Treasury is of the view that the Board should make similar amendments to IAS 38, regarding the recognition threshold. As currently drafted, IAS 38 will be inconsistent with the treatment adopted for non-financial liabilities. If the proposed amendments are made to IAS 37, without analogous amendments being made to IAS 38, this introduces bias or prudence, as intangible assets will be subject to higher recognition criterion than non-financial liabilities. This is inconsistent, given that the 'right' in IAS 38 is the reverse side to the obligation in IAS 37.

In particular, IAS 38 includes probability as part of the recognition criterion (para 21). For separately acquired intangible assets (paras 25 & 33), the probability recognition criterion will always be satisfied. However, for internally generated assets the probability recognition criterion may not be satisfied. For example, an entity must expense research costs because the entity cannot demonstrate that an intangible asset exists that will generate *probable* future economic benefits. Further, additional recognition criteria are included for assets arising from the development phase of an internal project (para 57).

However, the advantage of the current approach in IAS 38 is that it limits the recognition of internally generated intangible assets. This approach acknowledges the difficulties in determining whether an intangible asset qualifies for recognition, when an asset is not separately acquired. In contrast, the implication of adopting the proposed IAS 37 approach is to potentially increase the scope of assets and liabilities recognised. This is proposed, without addressing the associated difficulties in reliably measuring the future economic benefits.

Therefore, if the proposed IAS 37 approach to recognition is adopted, the measurement difficulties must also be addressed. This is further discussed in the response to Question 6.

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?*

Treasury agrees to the proposed amendments. However, we query whether in effect they narrow the operation of constructive obligations, as currently defined. In this regard, the proposal does not provide examples of items that would be constructive obligations under the current version of IAS 37, but not under the new proposals.

Treasury views this proposed amendment as a clarification only of what was already understood to be the effect of the current definition. That is, "a valid expectation on the part of those other parties" has been seen as synonymous with an expectation that those parties "can reasonably rely" on the entity to discharge those responsibilities.

But conversely, in the future, Treasury supports narrowing the definition of constructive obligations to a concept based on 'promissory estoppel' used in SFAS 143. This is necessary to address the potential conflict in the definition of a constructive obligation (para 10) and the definition of a liability, which states that the entity must have little, if any, discretion to avoid settling the obligation (para 13). The definition of a constructive obligation also needs to be reviewed for potential inconsistencies in treatment, particularly in regard to onerous contracts (refer response to Question 8(a)). However, it is acknowledged that any narrowing of the definition of a constructive obligation, impacts on liabilities generally, across a number of Standards and including the Framework. Therefore this is best addressed as part of the IASB project on liabilities and revenue recognition.

(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?*

Refer to Treasury's response to para (a) above.

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?

Treasury agrees, at a conceptual level, with the omission of the probability recognition criterion. However, we have the following concerns, which are further discussed below:

i Potential conflict with Framework;
ii Conflict with other Standards;
iii Impact of removing the probability recognition criterion;
iv Other internal inconsistencies in the proposed Standard;
v Interrelationships with other IASB projects.

(i) Potential conflict with Framework

Treasury agrees, at a conceptual level, with the omission of the probability recognition criterion. However, we have concerns with how it interrelates with the *Framework*. The Framework clearly states that prior to recognition, an item must satisfy separate definition and recognition criteria (paras 60, 82-83). Therefore, the Board's view (per para BC47) that the probability recognition criterion would have no effect in determining whether a liability should be recognised seems to conflict with the words in para 83 of the Framework, which states that:

"An item that meets the definition of an element should be recognised if:

(a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and
(b) the item has a cost or value that can be measured with reliability" (para 83).

This is also consistent with the recognition criterion in the current version of IAS 37.

The key word in para 83, quoted above, is "if". This implies, and therefore, contemplates a situation where a liability that meets the definition, is not recognised because it is not probable that the future economic benefits will flow from the entity. However, the proposed amendments are based on a view that in all cases, an unconditional obligation satisfies the recognition criterion. However, if this was the intent of the Framework, then it is unclear why probability would have been included as part of the recognition criterion at all. The Board's interpretation effectively relegates the probability criterion to a measurement issue only, which seems contrary to the intent of para 83 of the Framework.

In sum, it is not clear that the Board's view of the Framework adopted in the proposed amendments to IAS 37 is consistent with the Framework's intent. Therefore, while Treasury agrees, at a conceptual level, with the proposal to omit the probability recognition criteria in IAS 37, we are also of the view that this requires an amendment to the Framework at the same time, to avoid any potential conflict.

(ii) Conflict with other Standards

The draft amendments to IAS 37 also conflict with the approach taken in other Standards, such as IAS 38 *Intangible Assets*. As discussed in the response to Question 3, IAS 38 retains the probability recognition criterion. The implication in IAS 38 that the probability recognition criterion may not be satisfied for intangible assets not separately acquired is contrary to the concept of an unconditional obligation, as advanced in the proposed amendments to IAS 37.

Therefore, Treasury is of the view that if the proposed IAS 37 amendments are to be adopted, similar amendments to IAS 38 and other Standards are required at the same time, regarding the recognition threshold.

(iii) Impact of removing the probability recognition criterion

Adopting the proposed IAS 37 approach to recognition will potentially increase the scope of assets and liabilities recognised. More importantly, this will result in increased difficulty in reliably measuring the outflow of future economic benefits.

This issue may be addressed by providing additional guidance regarding the definition and measurement of unconditional obligations. 'Measurement' is discussed in the response to Question 6. The definition of a liability is discussed below.

The Board explains the concept of the 'stand ready' obligation, as an unconditional obligation to provide a 'service', which results in an outflow of economic benefits (para 24). While the concept of a provision of services works well with guarantees and product warranties, its application to other types of rights and obligations may be problematic.

For example, there are many instances where it may be argued that an entity is required to 'stand ready' that has not traditionally been regarded as a 'service' (e.g. to stand ready to perform as the court directs). But, in practical terms, these rights and obligations may not be recognised either because they may not meet the definition of a liability or because they cannot be reliably measured.

Additional guidance is therefore required to clarify the types of unconditional obligations that are being referred to (and that are not being referred to), and in what circumstances they arise, to ensure that a workable approach is adopted. In particular, in certain circumstances, it may be difficult to determine whether or not a *past event* has occurred and whether or not there is in fact an unconditional obligation. A stand ready obligation only arises where there has been a past event, such that the entity has little or no discretion to avoid the obligation. This means that a stand ready obligation does not exist in relation to any *future* reporting periods.

For example, in Government, an important issue is when to recognise a liability for social policy payments (e.g. old age pensions). In Treasury's view, a general 'stand ready' unconditional obligation to make social benefit payments in *future* reporting periods does not exist. This is because the entity has discretion to avoid the sacrifice of future economic benefits, as there has been no past event. This is also consistent with the view that the equivalent 'right to tax' cannot be recognised as an asset (refer response to Question 7).

An agreement for the provision of a service must also exist 'in-substance'. This is an important issue in Government, as it is sometimes difficult to determine whether 'in-substance', an agreement relates to a provision of a good or whether it is a non-reciprocal grant. This is also relevant in the private sector, as an agreement needs to be 'enforceable' for a liability to arise. The Standard, therefore, could include guidance regarding certain minimum features necessary to give rise to a liability (e.g. specification of what is being provided; enforceability etc).

(iv) Internally inconsistent

The proposed amendments to IAS 37 are also potentially inconsistent. For example, the draft amendments conclude that the initiation of a lawsuit creates an unconditional obligation, while a proposed change in law, that is not substantively enacted, does not result in an unconditional obligation. As noted in the Alternative View on the Proposed Amendments, attached to the Exposure Draft:

"...It seems difficult to justify this distinction between a prospective change in statute law (which may be highly probable) and the judgement of a court (which may be highly unlikely to lead to an obligation to pay, if the suit is vexatious or trivial), especially in those countries that have a common law system in which the courts determine the law." (para AV6)

It could be argued that, in both the disputed law suit and proposed change in law examples, the obligating event was the actual incident / action taken by the entity that exposed it to a potential law suit and changes in law. However, extension of this approach may not always be practical. As discussed above, it may be difficult to determine whether or not an unconditional obligation exists (and at what point), and measurement difficulties may prevent reliable measurement.

(v) Interrelationship with other IASB projects

Treasury has concerns that the Board is basing its conclusions on tentative decisions made in the IASB's Revenue Recognition project. In effect, the draft Standard is pre-empting the future direction of that project. For example, the Board has extended the tentative decisions of the Revenue Recognition project beyond the notion of contractual rights and obligations. Contractual rights and obligations arising from a guarantee and a warranty are clear. However, less so is the notion of unconditional rights and obligations arising from the "pursuit" of a lawsuit, or the "application for" an operating licence or the "process of negotiating" a customer contract (refer para BC16).

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?

No. Treasury has significant concerns regarding the proposals to measure 'stand ready' obligations, in the following areas:

i Two measurement options provided in the proposed Standard;
ii Impact of eliminating the probability recognition criteria;
iii Prudence – Inclusion of a risk margin;
iv Difficulties in incorporating future events in measuring an obligation.

(i) Two measurement options

Treasury is concerned that the proposed para 29 of IAS 37 provides two options, without identifying which option should take precedence. The first option is entity specific (i.e. amount that the entity would rationally pay to settle the obligation), while the second option is market determined (i.e. the amount to transfer it to a third party).

Application of these two options potentially gives rise to different results. The market determined measure is likely to give rise to a higher liability, as the market would generally seek a risk premium for assuming the liability of another entity. However, the inclusion of a risk margin may be excessively prudent, where it results in the overstatement of liabilities that is not supported by sufficient evidence. This is further discussed in para (iii) below.

Treasury does not support the retention of options, because the inclusion of options has the potential to reduce the comparability of the financial statements of different entities.

(ii) Impact of eliminating the probability recognition criteria

As discussed in the response to Question 5, the implication of omitting the probability recognition criterion, as proposed in the Exposure Draft, is to substantially increase the potential scope of non-financial liabilities.

However, in practice, the proposed definition is also likely to result in a commensurate increase in liabilities that are not recognised because they cannot be reliably measured. This increase in unrecognised liabilities is likely to represent single unconditional obligations that cannot be reliably measured. This is because, although there are known statistical methods to reliably measure a portfolio of similar obligations, there are no similar reliable measurement techniques for single obligations.

Put in other words, NSW Treasury does not agree with the unsupported assertion that entities can reliably measure liabilities, "except in extremely rare cases" (Exposure Draft, para 27). This assertion had validity under the current IAS 37 for probable obligations (and individually improbable obligations valued on a portfolio basis). But, the assertion cannot be extended to individual obligations that are improbable or remote (currently not recognised but disclosed as contingencies or not disclosed respectively).

Treasury's view is that it would undermine the reliability and credibility of financial statements if such liabilities were recognised as liabilities. Further, Treasury' view is that it would be difficult to find a Board of Directors to sign a set of financial statements that included such liabilities.

For example, with the disputed law suit example (Example 1), probabilities need to be determined regarding both whether the entity believes it will lose or win the law suit, as well as probabilities about both the amount and timing of the associated cash flows. For a single obligation (with no past experience), this may introduce such a degree of subjectivity as to make any estimate highly unreliable.

Treasury therefore recommends that para 27 be amended to acknowledge that, in many cases, it may not possible to reliably measure unconditional liabilities that have a wide range of possible outcomes regarding potential outflows of economic benefits. Instead, such liabilities should be disclosed as "liabilities that cannot be measured reliably" (applying para 69).

Conversely, if the IASB believes that such liabilities can be reliably measured, Treasury recommends that the IASB provides extensive, additional, detailed, practical guidance to demonstrate how such liabilities can be reliably measured.

In summary, Treasury believes that, as a result of the proposed amendments, the circumstances where liabilities are not recognised (because of difficulties in reliable measurement) will increase. To avoid this, additional amendments are required regarding both the nature of the unconditional obligation (refer response to Question 5) and measurement.

(iii) Prudence – Inclusion of a risk margin

Under both the proposed and current IAS 37, an entity must include the effects of risks and uncertainties when measuring a non-financial liability (para 35). Under the current IAS 37 and the "best estimate" approach, this has been interpreted consistently with the recognition of the central estimate or mean.

In contrast, the additional material in para 36 and the new Example 17 add an explicit risk margin to the central estimate. This appears to be inconsistent with other sections of para 36 which states that "uncertainty does not justify deliberate overstatement of liabilities". Adoption of this approach may result in recognition of a liability at more than the amount of cash that it would rationally pay to settle the obligation. This potentially conflicts with one of the measurement options in para 29.

This is the same difference as currently exists between the Australian Standard AASB 1023 *General Insurance Contracts* and IAS 37. AASB 1023 requires an additional risk margin to be added to the central estimate. This may be viewed as a form of 'risk premium' that the market would require to assume a liability of another entity as compensation for being less familiar with the risks attached to the liability.

In general, Treasury does not support recognising liabilities to include a risk margin. Adoption of a risk margin establishes an undesirable precedent that could be extended to any accounting measure where there is an element of uncertainty, including some asset valuations. Prudence is consistent with the current Framework. However, prudence is not consistent with the proposed Framework currently being developed by the Board, as financial information needs to be neutral and free from bias.

In summary, the addition of a risk margin to the central estimate is not supported as this perpetuates an approach based on prudence that is not supported by sufficient evidence.

(iv) Difficulties in incorporating future events in measuring an obligation

Treasury's view is that future events should only be incorporated in measuring an obligation, where there is sufficient objective evidence. Therefore, Treasury does not agree with removing the requirement that there be sufficient objective evidence. It is unrealistic to expect an entity to reliably incorporate the probabilities of future events, without there first being sufficient objective evidence. This is also contrary to the approach taken in other Standards, such as IAS 36, which requires the use of "reasonable and supportable assumptions".

Further, the proposed amendments appear to be inconsistent. According to the proposed amendments (para 42), it is acceptable for the entity to make assumptions about future events (no matter how remote) but the entity cannot make any assumptions about possible new legislation (even where it is highly probable), until the law is substantially enacted. While the proposed amendments distinguish the latter event, as creating a new obligation, the outcome is counter-intuitive.

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?

Conceptually, this is consistent with the other amendments proposed by the Board regarding unconditional obligations and is therefore supported. However, as with non-financial liabilities, the Framework recognition criterion for assets needs to be amended for consistency. This raises similar issues to that discussed in the response to Question 5 and Question 6.

In particular, further guidance is required regarding the nature and measurement of unconditional rights for reimbursements. For example, in government, the issue of the 'right to tax' may arise. To date, these rights have not been recognised, as they do not satisfy the definition of an asset in the Framework (para 49) i.e. they are not "*controlled* by the entity as a result of past events". A reimbursement right for *future* expenditure cannot be recognised as an asset, as there is no past event. This is also consistent with Treasury's view that the equivalent obligation to 'stand ready' to make social policy payments in *future* periods cannot be recognised as a liability (refer response to Question 5). Control over assets from non-reciprocal transfers, such as taxes or levies, normally can only be obtained when the decision has been made to impose a tax or levy.

Further, reimbursement rights, such as 'rights to tax' are essentially intangible assets. Given the Board's view that assets with contingencies should be addressed in IAS 38 (refer response to Question 3) it is unclear why a reimbursement right, which may be an intangible asset, remains within the scope of IAS 37. Under the current IAS 38, rights to tax are likely to fail the recognition criterion.

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?*

No. The proposed amendments potentially conflict with the recognition of constructive obligations. As a constructive obligation, it is conceivable that a liability for an onerous contract may be recognised prior to the entity taking any action. This would occur where an entity has made a sufficiently specific current statement to other parties that it will accept particular responsibilities and where the entity has created a valid expectation in those parties that they can reasonably rely on it to discharge those responsibilities.

But conversely, in the future and as discussed in the response to Question 4, Treasury supports narrowing the definition of constructive obligations to a concept based on 'promissory estoppel' used in SFAS 143. The SFAS approach to constructive obligations is more consistent with the proposed amendments to onerous contracts. However, as this is part of a wider issue, impacting a number of Standards and the Framework, this should occur as part of the IASB project on revenue and liabilities.

(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?*

Yes.

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

No (regarding (a) above). Treasury is of the view that proposed amendments need to be internally consistent and that this overrides convergence considerations.

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?*

Yes.

(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?*

No. Consistent with the response to Question 8(a), Treasury is concerned that the proposal to only recognise contract termination costs as a liability when the entity terminates the contract (i.e. when the entity takes the action), potentially conflicts with the requirements relating to the recognition of constructive obligations.

Under the proposed Standard, it is conceivable that a liability for contract termination costs may arise prior to the entity terminating the contract or ceasing to use the right conveyed by the contract. As a constructive obligation, a liability would arise where an entity has made a sufficiently specific current statement to other parties that it will accept particular responsibilities and where the entity has created a valid expectation in those parties that they can reasonably rely on it to discharge those responsibilities.

The treatment of contract termination costs is also inconsistent with the IAS 19 involuntary termination benefits. In contrast to recognition of the contract termination costs, a liability for involuntary termination benefits in IAS 19 would be recognised in advance of the entity actually terminating the contract, where certain criteria are met.

Therefore, any amendments regarding contract termination costs should be consistent with the recognition of constructive obligations, and the IAS 19 proposals regarding termination benefits. However, consistent with the response to Question 8(a) above, it is acknowledged that this issue may be addressed in future by limiting the definition of constructive obligations, similar to the approach taken in SFAS 143.

INVITATION TO COMMENT – AMENDMENTS TO IAS 19 EMPLOYEE BENEFITS

Question 1 – Definition of termination benefits

Do you agree with the amendment to the definition of termination benefits? If not, how would you characterise such benefits, and why?

Yes. However, the reference to voluntary termination payments only being available for a 'short period' should be explained or qualified. For example, it could be explained that such benefits should only be available for a short period, in regard to a specific and limited offer to encourage voluntary terminations, with an explicit closing date, normally within 12 months.

Question 2 – Recognition of termination benefits

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

Yes.

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

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?

Yes.