

25 October 2005

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Dear David

**ED 142 Proposed Amendments to AASB 137
'Provisions**

The Group of 100 (G100) submission to the IASB is attached.

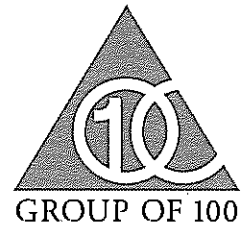
The G100 is concerned that these proposals represent a significant departure from the Framework itself in respect of the replacement of the probability approach to recognition of liabilities. We strongly believe that changing the concepts should be first resolved before those changes are reflected in proposed amendments to IFRSs.

However, if the IASB persists with this approach in making changes to IAS 37, these amendments should be adopted by the AASB for application in Australia. We believe failure to adopt changes made by the IASB puts at risk the benefits flowing from implementing the FRC's strategic directive and would not be in the best interests of the Australian economy.

Yours sincerely

Tom Honan
National President

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24 October 2005

Mr Harvey Rees
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Dear Mr Rees

Exposure Draft IAS 37 – 'Provisions.....'

The Group of 100 (G100) is an organisation representing the interests of Chief Financial Officers of Australia's largest business enterprises. The G100 is pleased to provide comments on IAS 37. Our responses to the questions raised follow.

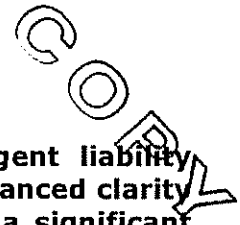
Q1 *All non financial liabilities not dealt with elsewhere are included in scope and the term 'provision' is superseded.*

The G100 agrees that this approach ensures that there are consistent requirements for all non-financial liabilities and that the use of the term 'provision' should be avoided.

Q2 *The term 'contingent liability' is no longer an acceptable description. A liability is an unconditional obligation and cannot be conditional or contingent.*

An obligation that is contingent or conditional on the non-occurrence of a future event does not by itself give rise to a liability (see para BC30). The Basis for Conclusions also explains that many items previously described as contingent liabilities satisfy the definition of a liability in the Framework. This is because the contingency does not relate to whether an unconditional obligation exists. Rather it relates to one or more uncertain future events that affect the amount that will be required to settle the unconditional obligation (see para BC23).

The Basis for Conclusions highlights that many items previously described as contingent liabilities can be analysed into two obligations: an unconditional obligation and a conditional obligation. The unconditional obligation establishes the liability and the conditional obligation affects the amount that will be required to settle the liability (see para BC24). The Exposure Draft proposes that when the amount that will be required to settle a liability (unconditional obligation) is contingent (or conditional) on the occurrence or non-occurrence of one or more uncertain future events, the liability is recognised independently of the probability that the uncertain future event(s) will occur (or fail to occur). Uncertainty about the future event(s) is reflected in the measurement of the liability recognised (see para 23).



The G100 believes that eliminating the term contingent liability (which is a confusing term) will eventually result in enhanced clarity and understanding in financial statements. However, a significant transition period is likely to be necessary to educate preparers and users on the implications of the change.

While there may be merit in the proposed approach dealing with unconditional and conditional rights and obligations from a conceptual perspective there are likely to be significant implementation difficulties in practice.

Q3 *The term 'contingent asset' will be eliminated. Assets arise only from unconditional (or non-contingent rights). An asset cannot exist where there are conditions or contingencies.*

The Basis for Conclusions also explains that many items previously described as contingent assets satisfy the definition of an asset in the Framework. This is because the contingency does not relate to whether an unconditional right exists. Rather, it relates to one or more uncertain future events that affect the amount of the future economic benefits embodied in the asset (see para BC17).

The Exposure Draft proposes that items previously described as contingent assets that satisfy the definition of an asset should be within the scope of IAS 38 Intangible Assets rather than IAS 37 (except for rights to reimbursement, which remain within the scope of IAS 37). This is because such items are non-monetary assets without physical substance and, subject to meeting the identifiability criterion in IAS 38, are intangible assets (see para A22 in the Appendix). The Exposure Draft does not propose any amendments to the recognition requirements of IAS 38.

The G100 agrees with elimination of the term 'contingent assets'. Where an item meets the definition of an asset it should be accounted for in accordance with the relevant asset standard, for example, IAS 38 where it deals with rights.

Q4 *The Exposure Draft proposes amending the definition of a constructive obligation to emphasise that an entity has a constructive obligation only if its actions result in other parties having a valid expectation on which they can reasonably rely that the entity will perform (see para 10). The Exposure Draft also provides additional guidance for determining whether an entity has incurred a constructive obligation (see para 15).*

It is not clear whether the Board's intention is to create a higher threshold for the recognition of constructive liabilities. If this is the case then any uncertainty as to the intention of the IASB should be resolved in the standard itself through the inclusion of clearer guidelines to ensure consistency in applying the definition and to ensure consistent interpretation of the circumstances that give rise to a constructive obligation.

For example, there is likely to be difficulty in identifying if a constructive obligation exists under the new definition because it is necessary to consider whether a counterparty can 'reasonably rely' on the entity to discharge its responsibilities and, therefore, be certain that a valid expectation has been created. This additional criterion is more stringent than the current standard and may result in fewer constructive obligations being recognised.

Q5 *The Exposure Draft proposes omitting the probability recognition criterion (currently in paragraph 14(b) from the Standard because, in all cases, an unconditional obligation satisfies the criterion. Therefore, items that satisfy the definition of a liability are recognised unless they cannot be measured reliably.*

The Basis for Conclusions emphasises that the probability recognition criterion is used in the Framework to determine whether it is probable that settlement of an item that has previously been determined to be a liability will require an outflow of economic benefits from the entity. In other words, the Framework requires an entity to determine whether a liability exists before considering whether that liability should be recognised. The Basis notes that in many cases, although there may be uncertainty about the amount and timing of the resources that will be required to settle a liability, there is little or no uncertainty that settlement will require some outflow of resources.

An example is an entity that has an obligation to decommission plant or to restore previously contaminated land. The Basis also outlines the Board's conclusion that in cases previously described as contingent liabilities in which the entity has an unconditional obligation and a conditional obligation, the probability recognition criterion should be applied to the unconditional obligation (ie the liability) rather than the conditional obligation.

So, for example, in the case of a product warranty, the question is not whether it is probable that the entity will be required to repair or replace the product. Rather, the question is whether the entity's unconditional obligation to provide warranty coverage for the duration of the warranty (ie to stand ready to honour warranty claims) will probably result in an outflow of economic benefits (see paras BC37-BC41).

The Basis for Conclusions highlights that the Framework articulates the probability recognition criterion in terms of an outflow of economic benefits, not just direct cash flows. This includes the provision of services. An entity's unconditional obligation to stand ready to honour a conditional obligation if an uncertain future event occurs (or fails to occur) is a type of service obligation. Therefore, any liability that incorporates an unconditional obligation satisfies the probability recognition criterion. For example, the issuer of a product warranty has a certain (not just probable) outflow of economic benefits because it is providing a service for the duration of the contract ie it is standing ready to honour warranty claims (see paras BC42-BC47).

This is a fundamental change in the application of a concept. The current probability criterion is well understood and applied in practice and replacing it is not supported at present.

The G100 believes that the probability criterion is embedded in the current framework and its application is well understood by business managers. We do not believe that the case for replacing it in the absence of fundamental changes to the Framework is justified at this stage. We consider that a change of this magnitude and significance should only occur after a substantial lead-time and an extensive program to re-educate accountants and users of financial statements. Additionally, on the grounds of consistency, the adoption of this approach in respect of IAS 37 is likely to have implications for other IFRSs.

In addition, where the most probable amount is not a reliable measure the unconditional obligation should not be recorded. For example, this can occur when the most probable amount might only have a low (say 20%) chance of actually occurring and the distribution of possible outcomes is sufficiently wide for it to be unlikely that the most probable amount is a materially accurate measure of the likely outcome.

- Q6 *The ED proposes that a non-financial liability be measured at the amount that it would rationally pay to settle the obligation or transfer it to a third party at balance date.*

Although supporting the approach in principle, the G100 considers that there are likely to be practical difficulties in implementation compared to the present approach in IAS 37 which reflects the principle that an obligation is measured on the basis of the most likely outcome. However, we consider that the differences from the present IAS 37 measurement and the reasons for those differences should be explained.

- Q7 *The ED proposes that a right of reimbursement for some of the economic benefits required to settle the non-financial liability be recognised as an asset where it can be reliably measured.*

The G100 agrees that separate recognition of the different components of a transaction rather than netting is appropriate.

However, in some circumstances it may be possible to measure reliably the net amount but not the amount of the gross liability and offsetting asset, for example, where the amount of an insurance deductible is known but the gross liability and therefore the amount that will be reimbursed by the insurer cannot be reliably measured. Perhaps there should be guidance in these circumstances as to what amount of liability (for example, the deductible amount) should be recorded and what associated disclosures should be made.

- Q8 *The Exposure Draft proposes that if a contract will become onerous as a result of an entity's own action, the liability should not be recognised until the entity takes that action. Hence, in the case of a property held under an operating lease that becomes onerous as a result of the entity's actions (for example, as a result of a restructuring) the liability is recognised when the entity ceases to use the property (see paras 55 and 57).*

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In addition, the Exposure Draft proposes that, if the onerous contract is an operating lease, the unavoidable cost of the contract is the remaining lease commitment reduced by the estimated sublease rentals that the entity could reasonably obtain, regardless of whether the entity intends to enter into a sublease (see para 58).

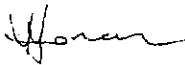
The G100 considers that further guidance is necessary to clarify what is meant in practice by 'an entity's own action'.

Q9 *The Exposure Draft proposes that non-financial liabilities for costs associated with a restructuring should be recognised on the same basis as if they arose independently of a restructuring, namely when the entity has a liability for those costs (see paras 61 and 62).*

The Exposure Draft proposes guidance (or provides cross-references to other Standards) for applying this principle to two types of costs that are often associated with a restructuring: termination benefits and contract termination costs (see paras 63 and 64).

The G100 supports the proposed approach to recognise a liability for each cost rather than the current approach of recognising a single liability.

Yours sincerely



Tom Honan
National President

c.c. Mr David Boymal, Chairman AASB