19 March 2010

Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins St West
MELBOURNE VIC 8007

Email: standard@aasb.gov.au

Dear Kevin

Comments on Exposure Draft ED 191 Measurement of Liabilities in AASB 137

Thank you for the opportunity to comment on the AASB Exposure Draft ED 191 Measurement of Liabilities in AASB 137. CPA Australia, The Institute of Chartered Accountants in Australia (the Institute) and the National Institute of Accountants (the Joint Accounting Bodies) have considered ED 191 and our comments follow.

The Joint Accounting Bodies represent over 180,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government, academia throughout Australia and internationally.

The Joint Accounting Bodies appreciate the concerns expressed in the ED around the measurement requirements for liabilities. Nevertheless, in order to ensure the adoption of a consistent measurement principle across similar liabilities we would have preferred these concerns to be addressed within the conceptual framework project, rather than the approach taken in the ED. We do acknowledge that for pragmatic reasons, the IASB cannot wait for the conceptual framework to deliver a comprehensive liability measurement principle. However, we would not support the direction of the project if the liability measurement principle was fundamentally different to that anticipated in respect of the other similar liabilities the subject of current IASB projects, such as revenue recognition performance obligations and insurance obligations.

Our response to matters on which specific comment is requested is included in the Attachment. Also attached is the submission of the Joint Accounting Bodies to the IASB which includes our' responses to the specific IASB question for comment and other comments that we made.

If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au, Kerry Hicks (the Institute) at kerry.hicks@charteredaccountants.com.au or Tom Ravlic (The National Institute of Accountants) at tom.ravlic@nia.org.au.

Yours sincerely

Alex Malley	Graham Meyer	Andrew Conway
Chief Executive Officer	**Chief Executive Officer**	**Chief Executive Officer**
CPA Australia Ltd	**Institute of Chartered Accountants in Australia**	**National Institute of Accountants**

AASB Specific Matters for Comment

The AASB would particularly value comments on whether:

a. there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

(i) not-for-profit entities; and
(ii) public sector entities;

The Joint Accounting Bodies are not aware of any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals.

b. overall, the proposals would result in financial statements that would be useful to users;

In the absence of the development of a comprehensive liability measurement principle in the conceptual framework, the Joint Accounting Bodies are generally supportive of the direction of the proposals. However, we have serious concerns about implicit profit recognition in relation to service contracts. Liabilities should represent the present value of expected cash flows the entity would rationally pay which inherently includes assessment of management intentions in this determination. Recording liabilities based on a concept similar to fair value which bears no resemblance to the cash outflows is not useful to users.

c. the proposals are in the best interests of the Australian and New Zealand economies.

Continuing to adopt IFRS is in the best interests of Australian and New Zealand economies. However we encourage the concerns expressed in the detailed letters to be addressed prior to adopting of any final standard.

19 March 2010

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
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United Kingdom

Email: CommentLetters@iasb.org

Dear Sir David

Comments on Exposure Draft ED/2010/1 Measurement of Liabilities in IAS 37

Thank you for the opportunity to comment on the IASB Exposure Draft ED/2010/1 Measurement of Liabilities in IAS 37. CPA Australia, The Institute of Chartered Accountants in Australia (the Institute) and the National Institute of Accountants (the Joint Accounting Bodies) have considered the above Exposure Draft (ED) and our comments follow.

The Joint Accounting Bodies represent over 180,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government, academia throughout Australia and internationally.

The Joint Accounting Bodies appreciate the concerns expressed in the ED around the measurement requirements for liabilities. Nevertheless, in order to ensure the adoption of a consistent measurement principle across similar liabilities we would have preferred these concerns to be addressed within the conceptual framework project, rather than the approach taken in the ED. We do acknowledge that for pragmatic reasons, the IASB cannot wait for the conceptual framework to deliver a comprehensive liability measurement principle. However, we would not support the direction of the project if the liability measurement principle was fundamentally different to that anticipated in respect of the other similar liabilities the subject of current IASB projects, such as revenue recognition performance obligations and insurance obligations.

The Joint Accounting Bodies' comments to the question and other comments are contained in the Attachment.

If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au, Kerry Hicks (the Institute) at kerry.hicks@charteredaccountants.com.au or Tom Ravlic (The National Institute of Accountants) at tom.ravlic@nia.org.au.

Yours sincerely

Chief Executive Officer
CPA Australia Ltd

Chief Executive Officer
Institute of Chartered Accountants in Australia

Chief Executive Officer
National Institute of Accountants

Question 1 – Overall requirements

The proposed measurement requirements are set out in paragraphs 36A–36F. Paragraphs BC2–BC11 of the Basis for Conclusions explain the Board's reasons for these proposals.

Do you support the requirements proposed in paragraphs 36A–36F? If not, with which paragraphs do you disagree, and why?

The Joint Accounting Bodies would like to see the issue of the measurement of liabilities addressed within the conceptual framework by the development of a comprehensive measurement principle, rather than the approach taken in the ED. However, we acknowledge that that is not the path being following. Accordingly, in the absence of direction from the conceptual framework project, the Joint Accounting Bodies support the proposed paragraphs 36A-36F. However, due consideration must be given by the IASB to ensure similar liabilities across different standards are measured in similar ways – thereby ensuring principles in the IASB's revenue recognition and insurance contracts projects are consistent.

We agree that rational behaviour implies a 'lowest of' notion'. Therefore, we agree it appropriate to measure the liability at the present value of the resources required to fulfil the obligation in the absence of evidence that an entity could cancel or transfer an obligation for a lesser amount.

Question 2 – Obligations fulfilled by undertaking a service

Some obligations within the scope of IAS 37 will be fulfilled by undertaking a service at a future date. Paragraph B8 of Appendix B specifies how entities should measure the future outflows required to fulfil such obligations. It proposes that the relevant outflows are the amounts that the entity would rationally pay a contractor at the future date to undertake the service on its behalf.

Paragraphs BC19–BC22 of the Basis for Conclusions explain the Board's rationale for this proposal.

Do you support the proposal in paragraph B8? If not, why not?

The Joint Accounting Bodies do not support the proposals in paragraph B8. We do not believe a requirement that the initial and subsequent measurements of a liability always use a contractor price to undertake the service on the entity's behalf (if available) will always produce information that is relevant to the decision-making needs of users. Our main concern with the use of a contractor price is that it implicitly includes a profit margin.

If it is rational behaviour for the entity to use a contractor, then it seems appropriate to measure the obligation on that basis. However, if it is rational behaviour for the entity to perform the service itself this should be reflected in the measurement. We believe that to do otherwise is not consistent with the *Framework for the Preparation and Presentation of Financial Statements* or the approach taken in Chapter 2 of the Exposure Draft *An improved Conceptual Framework for Financial Reporting.* The Framework paragraph 26 states that information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations. Paragraph 27 illustrates how users can make use of current information to predict the ability of the entity to take advantage of opportunities and its ability to react to adverse situations. The Exposure Draft Chapter 2 paragraph QC11 states to represent an economic phenomenon faithfully, an estimate must be based on appropriate inputs and each input must reflect the best information. We strongly suggest that the requirement to use always a contractor's price is not always consistent with producing information that has the characteristics required by the Framework or Chapter 2 of the Exposure Draft.

The Joint Accounting Bodies agree with the alternative views on the [proposed] Standard articulated at paragraphs AV2-AV4. We are not convinced by the Board's reasoning in paragraphs BC19-BC22. Paragraph BC21(a) states that the discipline of using the market prices of a contractor reduces subjectivity in measurements – management intention is not introduced. Although we can accept that point, we do not think this justifies a conceptually questionable rule. In addition, the general requirement to use the 'lower of' amount achieves the same objective.

The Joint Accounting Bodies do not agree with the assertion in paragraph BC21(d) that the contractor price is effectively the amount the entity would rationally pay to be relieved of the obligation. This assertion is based on the argument that this contractor price represents 'the value' (rather than the cost to perform the work) of the resources, the entity would have to sacrifice to fulfil the obligation. We disagree with this principle and believe that where it is rational behaviour for the entity to do the work itself in order to be relieved of its obligation, the resources expended should be measured by reference to cost. We do not accept the assertion in paragraph BC21(e) that the fulfilment of an obligation is a revenue generating activity and so should result in the recognition of a profit if fulfilled internally rather than paying an external contractor.

The Joint Accounting Bodies acknowledge that there are practical issues in determining which costs should be included in measurement of the liability. However, we do not believe this justifies a conceptually questionable rule because it is an 'easier' option (paragraph BC21(b)). Paragraph B8(b) acknowledges that where there is no market, the entity estimates the value based on cost plus a margin. Consequently, the [proposed] Standard is likely to result in calls for guidance on which costs to include.

Question 3 – Exception for onerous sales and insurance contracts

Paragraph B9 of Appendix B proposes a limited exception for onerous contracts arising from transactions within the scope of IAS 18 Revenue or IFRS 4 Insurance Contracts. The relevant future outflows would be the costs the entity expects to incur to fulfil its contractual obligations, rather than the amounts the entity would pay a contractor to fulfil them on its behalf.

Paragraphs BC23–BC27 of the Basis for Conclusions explain the reason for this exception.

Do you support the exception? If not, what would you propose instead and why?

Ideally, a comprehensive measurement principle should not result in exceptions. Therefore, in principle, the Joint Accounting Bodies do not support the exceptions articulated in paragraph B9. However, we acknowledge that in the absence of a clear overarching measurement principle for liabilities that the exceptions may be acceptable in the short term.. Accordingly, we agree with the limited exception for the reasons given by the Board in paragraphs BC23-27. We would like to see the limited temporary exception extended to warranty obligations that are currently recognised on a cost basis within the existing IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* . The current Discussion Paper relating to Revenue Recognition proposes a treatment different from both existing IAS 37 and the revised version proposed in the ED. Consequently, we suggest a similar temporary exemption for warranty obligations until the IAS 18 *Revenue* replacement is issued.

Other comments

- *Reliability of measurement*

  The Joint Accounting Bodies consider that determining the expected value based on the probability-weighted average of the outflows for a range of possible outcomes is the more relevant measure of a portfolio of liabilities whereas the most likely outcome is the more relevant measure of a single liability. We understand that for single obligations, determination of an expected value can be especially problematic, with substantial uncertainty as to both the possible outcomes and their associated probability. Further, there may be practicality issues in obtaining this evidence. The circumstances around single obligations are often unique, and it is difficult to determine what a party would rationally pay if there is no equivalent market.

  Consequently, we would envisage that many entities, faced either with unique circumstances such as lawsuits would determine that they are unable to measure the outcome reliably and claim non-recognition under paragraph 24 of the [proposed] Standard. We believe it would be helpful if the Board could acknowledge that unique and incomparable situations are difficult to measure reliably and provide some application guidance or illustrative example.

- *Risk margin*

  Conceptually we agree with incorporating a risk margin reflecting the uncertainties of measurement of an obligation. In fact, this often takes place today under the current IAS 37. However, we have considerable practical concerns with the approach in the standard and the possible of profit manipulation that may result. To address these issues further guidance will be required.

  Further, the [draft] illustrative example of a risk adjustment that is provided is not clear. The risk adjustments seem to take into account additional risks that arise because of uncertainties that are not incorporated into the contractor's price. It is not clear from the [proposed] Standard what additional risks are to be included. Some further guidance would be useful.

- *Own credit risk*

  The Joint Accounting Bodies note that the [proposed] Standard is silent about the place of "own credit risk" in liability measurement. We consider this silence inappropriate. We strongly suggest that this is an issue that is more appropriately addressed within the chapter on measurement models in the conceptual framework and we encourage the Board to explicitly exempt own credit risk from liability measurement until the conceptual framework is finalised.

- *Convergence with US GAAP*

  The Joint Accounting Bodies note that the measurement requirements of the [proposed] Standard do not align with the requirements of US GAAP. In the context of convergence with US GAAP we find this disappointing. We encourage the IASB to work with the FASB to establish common ground and move forward on a principles approach to liabilities measurement.

- *Illustrative Example*

  The Joint Accounting Bodies believe that an example illustrating the application of the measurement requirements of the standard to a lawsuit would be useful.