



The Institute of
Chartered Accountants
in Australia



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Dear Sir

Submission on Long-tail Liabilities Discussion Paper

The Institute of Chartered Accountants and the National Institute of Accountants (the professional bodies) welcome the opportunity to make a submission on the Long-tail Liabilities Discussion Paper. This submission focuses solely on the accounting issues raised in Chapter 2. We understand that CPA Australia are commenting on the paper separately on a wider range of issues and will include the same comments as below on Chapter 2 accounting issues.

This area of accounting is regulated by an accounting standard known as AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*. We expect this standard to be replaced in the first half of 2009. The International Accounting Standards Board (IASB) is of the view that the amendments clarify as opposed to change the operation of AASB 137. Other commentators have opined that the quantum of disclosure will be reduced. The IASB are still in the process of redeliberating the exposure draft in light of several roundtables that were held subsequent to the issue of the Exposure Draft. A complete summary of the project report can be obtained from the IASB website.

This submission is framed in the context of existing accounting guidance. It should be remembered, however, this discussion focuses on accounting in circumstances where an entity is a going concern. The underlying accounting assumptions change when an entity is insolvent. It is assumed an entity will have sufficient assets to cover liabilities over time. This may not always be the case.

Does AASB 137 have the effect that UFC liabilities are provisions or alternatively, contingent liabilities?

A provision is defined as a "liability of uncertain timing or amount" in the current accounting standard. A contingent liability is a possible obligation or a present obligation that is not recognised (either because it is not probable that an outflow of resources will be required to settle the obligation or because the amount of the obligation cannot be measured reliably). A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

An unascertained future personal injury claimant (UFC) is a long-tail liability - whether it is a liability for the purpose of the accounting framework will depend on the extent it satisfies the definitions above.

A long-tail liability requires an act or omission that will give rise to a claim to have occurred and the persons who in due course will have a claim against the company do not yet have a completed cause of action either because their injury has not yet become manifest or because an intervening event that will give them a completed cause of action has yet to occur.

The professional bodies' thoughts regarding the application of current standard are that it is the past action of the entity that is one factor relevant to the existence of an accounting liability. The other necessary factor is the expectation of an outflow.

The professional bodies believe that a UFC meets the existence factor for an accounting liability; however it may not be recognised due to there being a lack of evidence to support the expectation of an outflow of resources from the entity.

Whether or not a UFC is a contingent liability as opposed to a liability of uncertain timing and/or amount (i.e., a provision) is problematic. It is dependent on whether the liability is probable and/or can be measured reliably, and this will often depend on the extent and quality of information both within the entity and outside of the entity.

Does AASB 137 need to be clarified in relation to these matters?

The accounting standard already exists and deals with these types of liabilities, albeit through a principles approach rather than specific application to a UFC.

Existence and Recognition

We would expect that entities complying with accounting standards are already making an assessment of the existence and recognition any potential claims relating to asbestos manufacture (or the like) – whether they are solvent, restructuring or subject to external administration.

Measurement

The current standard adopts a 'best estimate' approach (the amount that an entity would rationally pay to settle or transfer the obligation at the reporting date) for the measurement of such UFC liabilities as well as providing some minimal guidance on measurement where probabilities are involved. In the actuarial industry a number of formal standards would apply to these types of liabilities. Corporations often engage actuaries to perform estimates for self insurance purposes. The measurement principles involved are likely to change when the new standard is released.

The professional bodies would not support the inclusion in the existing standard of any specific reference to UFC liabilities. Doing so would introduce material not found in the international standard. We support the adoption of international accounting standards and as such additions would contradict that objective.

We also note that the standards have been recently amended to remove the majority of Australian specific paragraphs or guidance. This was a result of the Financial Reporting Council's directive to the AASB that the audited financial reports for-profit entities be able to comply with international accounting standards. Accordingly, AASB 137 is the Australian equivalent to the IASB's IAS 37.

We would support an approach by the AASB to lobby for an example of a UFC to be included in the implementation guidance in respect of the new IAS 37 to be issued in 2009. This would be supported on the basis that the guidance contains a number of other examples and these are not included in the main body of the standard.

What are, if any, the practical implications for companies and others, if UFC liabilities were provisions or contingent liabilities?

The practical implications of these types of liabilities are associated with the ability to obtain a reliable measurement of any probable exposure.

The issues involved are complex, largely because of the uncertainty inherent in liability estimates of this type. Establishing a practical framework which can accommodate this uncertainty will be a key challenge and is being reviewed by the IASB as part of the project to update this standard.

It is unlikely that an entity will be able to determine the probability of settlement along with a reliable measurement without some expert advice, usually by an appropriately qualified actuary.

If UFC liabilities were not to be treated as provisions or contingent liabilities, should there be some other disclosure requirement?

The extent of disclosure for provisions or contingencies varies in the current standard, as follows:

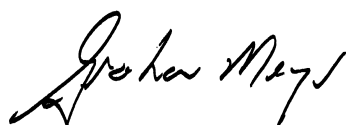
- The nature of material provisions are required to be disclosed and the uncertainties about the amount or timing of outflows to be indicated.
- Contingent liabilities, unless they are considered to be remote, are required to be described and where practicable estimates provided along with indications of uncertainties relating to the amount or timing of any outflow.

Therefore where UFC are assessed as provisions or contingent liabilities that are not determined to be remote, they are already subject to disclosures under the current standard. It should be noted that these disclosure requirements specify a minimum set of disclosures and the professional accounting bodies support entities providing greater disclosure to users of financial statements. We do not support commentators that recommend no form of disclosure of liabilities of the kind contemplated by this inquiry appears in the financial statements of solvent companies.

If UFC liabilities did not meet the criteria as provisions or contingent liabilities we do not support any other form of disclosure requirements.

Please feel free to contact Kerry Hicks (the Institute of Chartered Accountants in Australia) on 02 9290 5703 or Tom Ravlic (NIA) on 03 8665 3143 should you wish to discuss any issues further.

Yours faithfully



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