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17 March 2010

Dear Kevin

EXPOSURE DRAFT 191 - ED/2010/1 Measurement of Liabilities in AASB 137/IAS 37

Grant Thornton Australia Limited (Grant Thornton) is pleased to provide the Australian Accounting Standards Board with its comments on the Board's Exposure Draft ED 191 which is a re-badged copy of the International Accounting Standards Board's (the Board) Exposure Draft ED/2010/1 *Measurement of Liabilities in IAS 37* (the ED). We have considered the ED as well as the accompanying draft Basis for Conclusions.and set out our comments below.

Grant Thornton's response reflects our position as auditors and business advisers both to listed companies and privately held companies and businesses, and this submission has benefited with input from our clients, other overseas Grant Thornton firms, and discussions with key constituents.

Appendix 1 contains our more detailed preliminary responses to both the IASB's and the AASB's questions.

Summary of our views
Exposure Draft ED/2010/1 Measurement of Liabilities in IAS 37

We are generally supportive of the underlying measurement objective and the general measurement proposals. In particular we support the use of the amount an entity would rationally pay to settle as the overall measurement objection; and the 'lowest of' guidance in paragraph 36B.

However, we do not agree with the proposals relating to obligations to be fulfilled by providing a service (the proposals in B8). We do not see how a requirement to use contractor prices (if available) is consistent with the basic measurement objective (the amount the entity would rationally pay to be relieved of the obligation). If the entity intends to perform the service itself it has presumably concluded rationally that this will involve a lower outflow of resources. Consequently, this should be reflected in the measurement of the liability.

If you require any further information or comment, please contact me.

Yours sincerely
GRANT THORNTON AUSTRALIA LIMITED

Keith Reilly
National Head of Professional Standards

Appendix 1:
Responses to ED Questions

Responses to invitation to comment questions

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?

In our October 2005 comment letter on the earlier ED, we supported retaining 'most likely outcome' in paragraph 40 of existing IAS 37, on practicality grounds. However, the arguments in BC1-18 are persuasive and the use of 'expected value' is more consistent with other IFRSs (eg IFRS 3R and IAS 39). Consequently we support the proposed requirements in paragraphs 36A-36F.

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?

No - we do not agree with the proposals in paragraph B8.

We do not see how a requirement to use contractor prices (if available) is consistent with the basic measurement objective (the amount the entity would rationally pay to be relieved of the obligation). If it is rational to use a contractor, then most entities will do so and it seems appropriate to measure the obligation on that basis. If the entity intends to perform the service itself, then it has presumably concluded that this will involve a lower outflow of resources and, in turn, this should be reflected in the measurement.

We are sympathetic to the alternative views expressed in AV2-AV4 and are not convinced by the Board's reasoning in BC19-BC22, which seems confused. In BC21(a) they argue that the use of contractor prices will ensure greater 'discipline' in using observable market prices. Although we can accept that point, we do not think this justifies a conceptually questionable rule. Also, the general requirement to use the 'lower of' amount achieves the same objective.

We do not agree with the assertion in BC21(d) that the contractor price is effectively the amount the entity would rationally pay. This assertion is based on the argument that this contractor price represents 'the value' (rather than the cost) of the resources the entity would have to sacrifice to fulfil the obligation.

We disagree with this principle and believe that where the entity will fulfil the obligation internally, whether through the supply of goods or provision of services, the resources expended should be measured by reference to cost. We do not accept the assertion in 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.

Although we accept that there are practical issues in determining which costs should be included in measurement of the liability, we do not believe this justifies a conceptually questionable rule because it is an 'easier' option (BC21(b)). Also, B8(b) acknowledges that where there is no market, the entity estimates the value based on cost plus a margin. Consequently, guidance on costs is still needed.

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?
We agree with the limited exception for the reasons given by the Board in BC23-27. However, such reasons are equally applicable to the treatment of warranty obligations which are currently recognised on a cost basis within existing IAS 37. 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 replacement is issued.

Other comments
Reliability of measurement
For single obligations, determination of an expected value can be especially problematic, with substantial uncertainty both as to the possible outcomes and their associated probability. These are often unique circumstances, 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 ED paragraph 24. This paragraph attempts to restrict its use to "extremely rare cases", so widespread use would adversely affect perceptions of the quality of the standard. Further, it would cast concern over the efficacy of similar "rare case" wording in other standards (such as IFRS 2 Share Based Payment). It would therefore 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.

Specific AASB Questions

1 Whether 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:

a not-for-profit entities; and
b public sector entities.

Response

Apart from our earlier comments, we are not aware of any regulatory issues that may effect the implementation of the proposals.

2 Whether, overall, the proposals would result in financial statements that would be useful to users.

Response

Apart from our earlier comments, we are not aware of any regulatory issues that may effect the implementation of the proposals.

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

Response

Apart from our earlier comments, we are not aware of any regulatory issues that may effect the implementation of the proposals.