

TREASURY ANALYSIS – INTERNATIONAL ACCOUNTING STANDARDS

AASB 137 “Provisions, Contingent Liabilities and Contingent Assets” replacing AASB 1044 “Provisions, Contingent Liabilities and Contingent Assets”

Major impacts of changes

- Changed treatment applies for contingent assets and recoveries receivable:
 - Assets only recognised when the related realisation of revenue or expected recovery receivable is *virtually certain* (previously when probable).
 - Contingent assets disclosed when realisation of revenue or the expected recovery is *probable* (previously when higher than remote but less than probable).
- Recognition of provisions associated with the retirement or disposal of long-lived assets.
- Where an operation is to be sold, a provision for restructuring can only arise where there is a binding sale agreement.
- Where discounting is used, the increase in the carrying amount of the provision due to the passage of time must be recognised as a borrowing cost.
- Additional disclosures, including the expected timing and uncertainty about timing of outflows of economic benefits to settle the provisions.

Key features of Standard

- AASB 137 substantially replicates the requirements of AASB 1044, except for the areas discussed below under “main differences”.
- Also, AASB 137 has a narrower scope than AASB 1044 as it:
 - Excludes financial instruments within the scope of AASB 139 *Financial Instruments: Recognition and Measurement* (including guarantees) and insurance contracts under AASB 4 *Insurance Contracts* and AASB 1023 *General Insurance Contracts*.
 - Dividends are explicitly addressed as part of AASB 110 *Events after the Balance Sheet date*, rather than AASB 137. Previously these were addressed in AASB 1044. Refer Treasury Analysis on AASB 110 for further discussion.

Main differences compared to current Australian requirements

- *Contingent assets and recoveries receivable* –
 - *Recognition* – AASB 137 adopts a “prudent” approach and requires an asset to be recognised when the related realisation of revenue or expected recovery receivable is *virtually certain* (para 33 and 53). Previously, recognition was required when the realisation and expected recovery were *probable*.
 - *Disclosure* – AASB 137 requires disclosure of contingent assets when realisation of revenue is *probable* (para 89). Previously disclosure was required when the likelihood of inflow of economic benefits is *higher than remote but is not probable*.
 - *Inconsistent with treatment of contingent liabilities* – The AASB 137 treatment of contingent assets and recoveries receivable is inconsistent with the treatment of contingent liabilities. That is, liabilities are recognised when outflows of resources are probable and disclosed when higher than remote but less than probable (para 28 and 30).
- *Retirement or disposal of long lived assets (restoration provisions)* –
 - AASB 137 applies to provisions for the retirement or disposal of long-lived assets (para 19-22, Examples 2A, 2B and 3, Appendix C). These types of provisions were excluded from the scope of AASB 1044.
 - Obligations may be legal *or* constructive (para 17).
 - Only obligations arising from *past events* (i.e. an obligating event) existing independently of an entity’s future actions are recognised as provisions (para 19), e.g. (see Example 3):
 - As a consequence of installation; or
 - As a consequence of using the item.

- An intention to operate differently in future is not a present obligation because there is no obligating event e.g. intention to fit smoke filters in a factory (para 19 and Appendix C, Example 6).
- Restoration costs incurred must also be recognised as part of the cost of an item of PP&E (refer *Treasury Analysis* on AASB 116).
- Examples in the Standard include provisions for (para 19):
 - Penalties or clean-up costs for unlawful environmental damage;
 - Decommissioning costs of an oil installation or nuclear power station to the extent the entity is obliged to rectify damage already caused.
- *Discounting* – AASB 137 provides that where discounting is used, the increase in the carrying amount of the provision due to the passage of time must be recognised as a borrowing cost (para 60). AASB 1044 provided that, while conceptually this component should be classified as interest, that the cost of doing so exceeded the benefit. As a result, AASB 1044 did not treat this as interest.
- *Restructurings when an operation is to be sold* – AASB 137 provides that where an operation is to be sold, a provision for restructuring can only arise where there is a binding sale agreement (para 78). In contrast, AASB 1044 allowed a provision for restructuring even though there was no binding sale agreement, provided there was a detailed formal plan and the entity had started to implement the plan or announced its main features such that there was no realistic alternative but to proceed with the restructuring.
- *Third party recovery* – Unlike AASB 1044, AASB 137 does not specifically address the set-off of provisions and related assets from expected third party recoveries, where there is a legal right of set-off.
- *Additional disclosures* – For each class of provision (para 84-85):
 - Expected timing of outflows of economic benefits;
 - Indication of uncertainties about the timing of those outflows;
 - Increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.

Impact on the public sector

- Not-for-profit and for-profit entities are subject to identical requirements.

Policy and Implementation issues (see attached)

Policy

- *Onerous contracts* – AASB 137 requires (as did AASB 1044) recognition of onerous contracts (para 66) i.e a contract in which the unavoidable costs of meeting the obligation under the contract exceed the economic benefits expected to be received under it. Treasury will need to retain and update guidance in Treasury Circular NSWTC 03/06 regarding onerous contracts. This will confirm that the concept of onerous contracts is only relevant to the public sector in limited circumstances. For example, where a public sector entity provides social benefits by delivering health, education, transport and other social services to the community any contract to provide such benefits cannot be regarded as an onerous contract under AASB 137.

First time adoption - Estimates

- AASB 1 on *First Time Adoption* prohibits retrospective application of other Australian equivalents to International Financial Reporting Standards (AIFRSs) relating to “estimates” (which would include “provisions”) (AASB 1, para 26). This modifies the application of AASB 110 *Events After the Balance Sheet Date*, in certain instances. Specifically, AASB 1 provides that an entity’s estimates under AIFRS at the date of transition (i.e. 1 July 2004 for 30 June entities) must be consistent with estimates made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were made in error (AASB 1, para 31).

This means that where an entity receives information after 1 July 2004, about estimates that it made under Australian GAAP, that information must be treated as a non-adjusting event, assuming there are no errors and no differences in accounting policies (AASB 1, para 32). The new information must be reflected in the income statement for the comparative period in the first AIFRS financial report.

Other Implementation issues

- *Restoration provisions* – An entity must determine whether it has any legal or constructive obligations for restoration provisions. In making this assessment, the entity must consider the likelihood for dismantling / restoration and the time period until restoration (i.e. the effect of discounting must be taken into account). Reference should also be made to UIG Abstract 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* (this is the Australian Equivalent of IFRIC 1) and to AASB 1 para 25E. AASB 1 provides an alternative to retrospective application and allows an entity to include in the depreciated cost of the asset at the date of transition an amount calculated by discounting the liability at that date back to, and depreciating it from, when it was first incurred.
- *Contingent assets and recoveries receivable* – Agencies may need to derecognise certain assets where they are probable but not virtually certain. Instead these items will be disclosed in the notes to the financial statements.
- *Discounting and effect of passage of time* – Agencies will need to separately identify changes in provisions due to the passage of time as borrowing costs.

This summary has been written in general terms and is intended for general reference only. Agencies should review the contents of the AASB Standard to determine its application in particular circumstances.

**SUMMARY OF POLICY, IMPLEMENTATION & SYSTEM ISSUES
AASB 137 “PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS”
TREASURY & AGENCIES**

	Issue	Treasury Policy		System/ Implementation Issue	Mandate Options for GFS Harmonisation	Budget / Total State Sector Issues
		Mandate Option	Additional Guidance			
1	Onerous contracts – retain and update NSWTC 03/06		✓			
2	Restoration provisions – review whether any exists			✓		✓
3	Restoration provisions – first time adoption (AASB 1, para 25E) – need not apply UIG Abstract 1 retrospectively	✓				
4	Contingent assets and recoveries receivable – derecognise where probable but not virtually certain			✓		✓
5	Discounting and effect of passage of time – separately calculate and disclose			✓		✓