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Dear Sir

Submission on Long-tail Liabilities Discussion Paper

CPA Australia welcomes the opportunity to make a submission on the Long-tail Liabilities Discussion Paper. This submission responds to most of the issues raised. The submission of the Institute of Chartered Accountants in Australia and the National Institute of Accountants was confined to commenting on the accounting issues raised in Chapter 2 and is the same (as below) on Chapter 2 accounting issues.

Chapter 2 Current position (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.

Our submission on Chapter 2 accounting issues 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.

CPA Australia's 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.

CPA Australia believes 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.

CPA Australia 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 vary 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 CPA Australia supports 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.

Chapter 3 The Referred Proposal

CPA Australia acknowledges and supports the general thrust of the Referred Proposal, but would like to express some reservations particularly with respect to the potential uncertainty and scope for wide interpretation within some of the test key terms.

Chapter 4 Threshold test of 'mass future claims'

4.1.1 Arguments for this test

CPA Australia agrees that it is necessary to have within the legislation an appropriate threshold which limits the operation of any scheme for dealing with mass long-tail liabilities only to those companies with a significant level of unfunded claims, specific identification of which will emerge well into the future. In addition to confining claimant protection in a practical and predictable manner, we believe that within such a test there ought additionally be acknowledged the need to:

- adequately recognise and facilitate the meeting of significant personal injury claims of a particular character, and
- facilitate the better conduct of the interface between corporate legal personality and the tort of negligence.

4.3.1 General comments

CPA Australia disagrees with the submission referred to (the Australian Conservation Foundation) which suggests that the Referred Proposal test is too narrowly based. The addressing of long-term economic and environmental harm through the Proposal mechanism potentially confuses both the recognition and remedial treatment of tortuous or wrongs based obligations with positive duties which are typically embodied in statute. Similarly, with regards the various categories of tort and equitable wrong, the scope of definition needs to be at least as narrow as contemplated to ensure that the variety of harms which can be give rise to are treated in a predictable and consistent manner.

4.4.1 Definition by regulation

CPA Australia rejects this alternative to the Referred Proposal. Such a regulatory prescribed approach runs the risk of being contradictory to the nature of emergent mass-tort liability by placing a regulator in the position of declaring which products or industries are going to be regarded as giving rise to long-tail liabilities. This potentially shifts the onus for identification of possible liability away from the tortfeasor with whom the duty of care correctly sits. Additionally, this form of regulatory declaration without any apparent court intervention or approval, may be seen as inferring an admission of liability for which the affect company may wish to challenge.

4.4.2 Application of accounting standards

CPA Australia recognises some merit in seeking consistency in the definitions of 'mass future claims' and 'contingent liability' as it is important to avoid, or at least minimize, disharmony between definitions and tests contained respectively in the Corporations Act and accounting standards. It is emphasised however that the Act and accounting standards serve differing purposes such that the latter whilst driven by considerations of disclosure utility, should not be excessively relied upon as a basis for managing complex legal obligations.

4.5 Possible alternative test of 'mass future claim'

CPA Australia acknowledges the potential value in this lower threshold test. The very nature of long-tail tort liability is such that the obligations arise over an extended period of time making quantification highly problematic. There is some likelihood that the carve-out contained in the Referred Proposal could preclude in some complex instances the warranted orderly management of emergent liability.

Chapter 5 Solvent companies

5.2 to 5.5 share capital reduction, share buy-back and financial assistance provisions

Whilst recognising the need for companies to manage their capital structure in the most economic efficient manner, CPA Australia agrees that the existing creditor protection principle embodied in s 256B(1)(b) should be extended to protect the interests of UFCs. Similarly, it is arguable that the financial assistance rule should be amended in a similar manner, though with regards dividend declaring rules, the situation is less certain given the more routine nature of providing financial returns to members.

5.8 Insolvent trading and 5.10 Directors' duties

We provide no specific comment on these matters other than to point to possible wider consideration of these matters being given as an outcome of Treasury's 2007 Review of Sanctions in Corporate Law.

Chapter 6 Voluntary administration

The Discussion Paper's reference to solvent companies supports incremental development in the law to give appropriate recognition to the interests of unascertained future tort claimants. As such, CPA Australia suggests that the voluntary administration provisions should likewise appropriately accommodate this type of claimant. Complexities nonetheless arise, particularly with regards the balancing of UFC claims with the underlying business recovery objective of the voluntary administration regime. However, we do not believe that it is acceptable to proceed with Option 2, which largely represents the status quo position.

Whilst Option 1 reflecting the Referred Proposal is viewed by CPA Australia as containing merit, the following observations are made. To enable ongoing management of emerging liabilities to work within the structure of a deed of company arrangement (DOCA), there is likely to be greater demands on the supervisory and review functions of the courts involving such matters as the appointment of a UFC representative and defining what rights such representatives have in relation to voting on the DOCA. On this rationale, we likewise support Option 4 as being the least intrusive on the widely accepted and supported rationale of the voluntary administration regime. Similarly, the continuity of representation envisioned in Option 4 avoids the inflexibility potentially given rise to in the suggested variation (6.3.2) to Option 1 that would see the establishment of a fixed monetary provision.

Concerning Option 3, this likewise presents its own practical difficulties. The expectation that directors would be in the position to give the type of certification described, and thus render themselves personally liable for misstatements, is possibly contradictory to the objective of the voluntary administration procedure which seeks to provide a relatively quick and certain resolution to a company's financial difficulties. Further, potential uncertainty around the development of joint tortfeasors in the specific context of long-tail liability, would seem to act against the practicality of this option.

Chapter 7 Schemes of arrangement

We make no specific comment in relation to this chapter of the Discussion Paper.

Chapter 8 Liquidations

CPA Australia supports the Referred Proposal in its dealing with insolvent companies and in particular sees merit in the more certain basis for quantifying the emergent liability through actuarial assessment along with court involvement in approving the establishment of a trust fund, as outlined in section 8.4 of the Discussion Paper. The proposed level of court supervision is potentially significant in the handling of those instances where the return to unascertained future claimant is potentially miniscule and, as a matter of efficiency, the liquidation should be allowed to run its course.

Additionally we support the discussion at 8.1.2 concerning the determining of insolvency in the context of s 459D(1) and acknowledge that the description of contingent liability as outlined in AASB 137 as possibly extending beyond that described by Young CJ in *Edwards v Attorney General (NSW)* ([2004] NSWCA 272 at paras 59 – 60) where a distinction is drawn between contingent and prospective creditors, on the one hand, and possible future claims that might crystallise, on the other. In CPA Australia's view, the conclusion in the Discussion Paper (page 80) that this may facilitate a court's discretion in making an insolvency assessment, does not of itself amount a clear basis of proving a UFC claim.

Notwithstanding the widely acknowledged difficulty of both quantifying and managing the ongoing emergent nature of UFC claims, there seems little to be added by adopting the more formalised recognition of claim applying in the UK as described in 8.1.3 of the Discussion Paper.

Chapter 9 Anti-avoidance

9.1 Anti-avoidance provision

We give broad support to the development of a statutory avoidance provision modelled on the existing Part 5.8A of the Corporations Act. Whilst acknowledging the presence of only limited judicial consideration having been given to Part 5.8A, the inclusion in statute of such schemes can function as a deterrent to opportunistic abuse of the corporate form.

9.6.3 Policy options in relation to priority

Whilst *Option 4* may be seen as adding further complexity to the final resolution of a corporate insolvency, it does however in our view have the advantage of reflecting and preserving the current order of statutory priorities. If, as would seem the case with *Option 1*, UFC claimants were through the trust arrangement to be the sole beneficiaries of a recovery under an anti-avoidance regime, this would create a disharmony with the current structure of priorities as set out in s 556.

If there is considered merit in granting a priority to non-adjusting tort claimants, this should be approached via amendment of s 556 itself. Such development is acknowledged as contentious and likely beyond the scope of CAMAC's present deliberations. We however mention in passing that greater clarity could be given to the scope and nature of the injury compensation priority provided in s 556(1)(f) and that this specific provision might be applied in those circumstances where the UFC claimant is also an employee or former employee.

Please feel free to contact Dr Mark Shying on 03 9606 3903 (Chapter 2 accounting issues) or John Purcell (all other issues) on 03 9606 9826 should you wish to discuss any issues further.

Yours sincerely

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