



IAS 37 Provisions, Contingent Liabilities and Contingent Assets

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Objective of IAS 37

- The objective of IAS 37 is to ensure that appropriate recognition criteria and measurement bases are applied ... key principle established ... is ...

[Scope of IAS 37]

- IAS 37 excludes obligations and contingencies arising from: [IAS 37.1]
- financial instruments carried at fair value (but IAS 37 does apply to financial instruments carried at amortised cost)
- non onerous executory contracts
- insurance company policy liabilities (but IAS 37 does apply to non policy related liabilities of an insurance company)
- items covered by another IAS:
- ...

Key Definitions

- **Provision:**
- A liability of uncertain timing or amount.
- **Liability:**
- Present obligation as a result of past events
- Settlement is expected to result in an outflow of resources (payment)
- **Contingent liability:**
- a possible obligation depending on whether some uncertain future event occurs, or
- a present obligation but payment is not probable or the amount cannot be measured reliably
- **Contingent asset:**
- a possible asset that arises from past events, and
- whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise

Recognition of a Provision

- An enterprise must recognise a provision if, and only if:
- a present obligation (legal or constructive) has arisen as a result of a past event (the obligating event),
- payment is probable ('more likely than not'), and
- the amount can be estimated reliably. [IAS 37.14]

Measurement of Provisions

- The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date, that is ...
- This means:
 - Provisions for one off events (restructuring, environmental clean up, settlement of a lawsuit) are measured at the most likely amount. [IAS 37.40]
 - Provisions for large populations of events (warranties, customer refunds) are measured at a probability weighted expected value. [IAS 37.39]
 - Both measurements are at discounted present value using a pre tax discount rate that reflects the current market assessments of the time value of money and the risks specific to the liability. [IAS 37.45 and 37.47]
- In reaching its best estimate should take into account the risks and uncertainties that surround the underlying events

Remeasurement of Provisions

- Review and adjust provisions at each balance sheet date
- If outflow no longer probable, reverse the provision to income.
- [IAS 37.59]

[Some Examples of Provisions 1]

- We will examine now a number of examples here that will help us to establish the principles involved in whether a provision should be accrued

Some Examples of Provisions 2

Circumstance

Accrue a Provision?

Restructuring by sale of an operation

Restructuring by closure or reorganisation

Warranty

Land contamination

Restructurings 1 a

- A restructuring is
 - Sale or termination of a line of business
 - Closure of business locations
 - Changes in management structure
 - Fundamental reorganisation of company

[Restructurings 1 b]

- Restructuring provisions should be accrued as follows: [IAS 37.72]
- **Sale of operation:** accrue provision only after a binding sale agreement [IAS 37.78] If the binding sale agreement is after balance sheet date, disclose but do not accrue
- **Closure or reorganisation:** accrue only after a detailed formal plan is adopted and announced publicly. A board decision is not enough.
- **Future operating losses:** Provisions should not be recognised for future operating losses, even in a restructuring
- **Restructuring provision on acquisition (merger):** Accrue provision for terminating employees, closing facilities, and eliminating product lines only if announced at acquisition and, then only if a detailed formal plan is adopted 3 months after acquisition. [IAS 22.31]

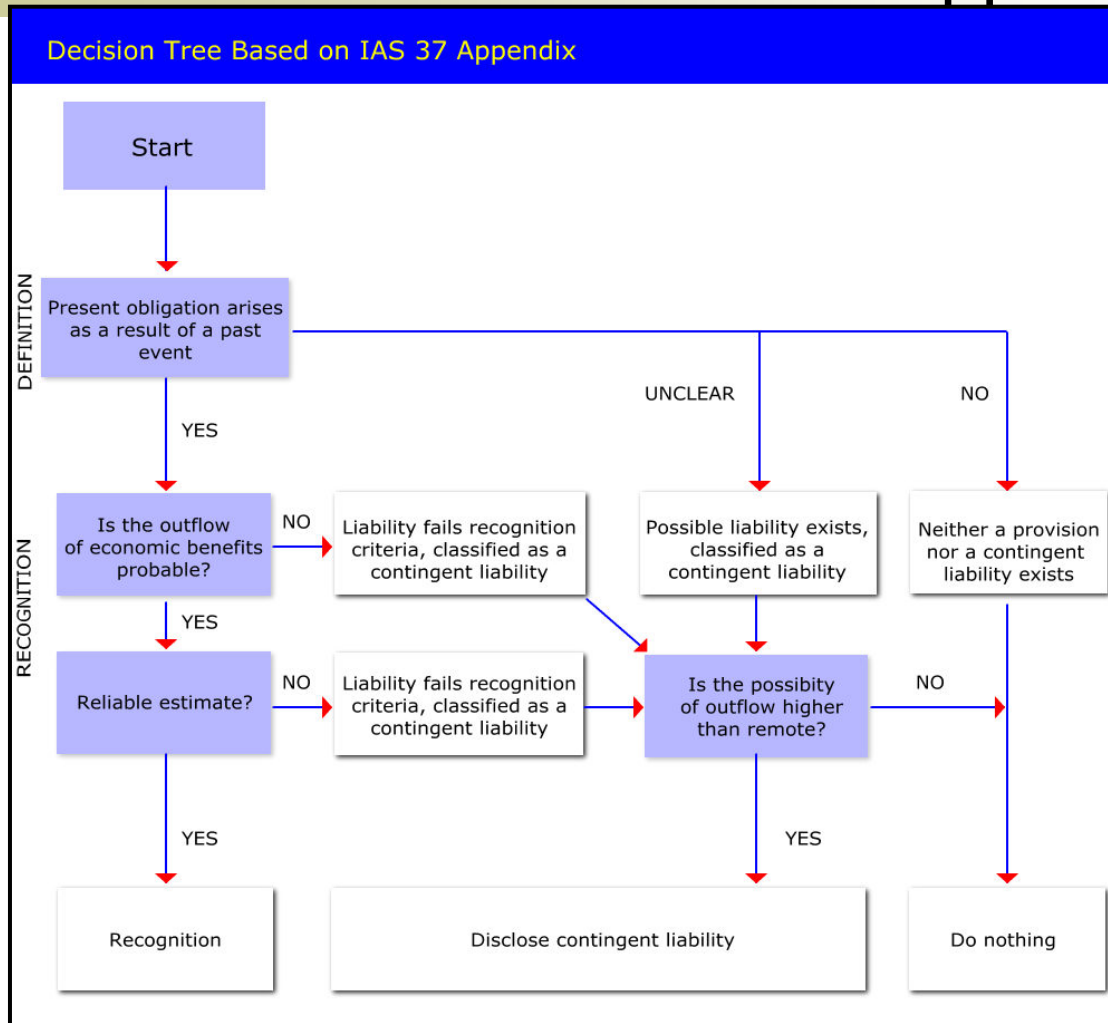
[Restructurings 2]

- What Is the Debit Entry?
- Use of Provisions
- Contingent Liabilities
- Contingent Assets

[Disclosures]

- Reconciliation for each class of provision:
- ...
- [IAS 37.84]
- A prior year reconciliation is not required.
[IAS 37.84]
- For each class of provision, a brief description of:
- ...
- [IAS 37.85]

Decision Tree Based on IAS 37 Appendix



Examples to Explain the Concepts in the Standard: taken from the Appendix C to the Standard

- We will look at a wide variety of examples to help us to understand this Standard

[Reference]

- I recognise the help I received from the materials prepared by Deloitte, Touche, Tohmatsu in preparing this presentation.