IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

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SCOPE AND DEFINITIONS

Apply to all:
- **Provisions =** liability of uncertain timing or amount.
- **Contingent liabilities =** possible obligation arising 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 entity; OR
  - Present obligations arising from past events but is not recognized because:
    - An outflow of economic benefits is not probable; OR
    - Amount of the obligation cannot be measured with sufficient reliability.
- **Contingent asset** = 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 entity.

DO NOT apply to:
- Executory contracts, except where the contracts are onerous;
- Provisions, contingent liabilities/assets covered by other standards:
  - E.g. construction contracts, income taxes, leases, employee benefits, insurance contracts, financial instruments and contingent considerations of an acquirer in a business combination (IFRS 3).

MEASUREMENT

The amount recognised as a provision shall be the ***best estimate*** of expenditure required to settle the ***present obligation*** at the *end* of the reporting period.

Best estimate = amount would rationally pay to settle/transfer the obligation.
- Use weighted average probability of possible outcomes, if appropriate.
- Involves judgment, experience, evidence from events after the reporting period and, in some cases, use of independent experts.

Risk and uncertainties:
- Those that inevitably surround many events and circumstances are taken into account in ***best estimate***.
- Risk describes variability of outcomes.
- Avoid excessive prudence and duplication of risk adjustments.

Present value (PV):
- Use PV if effect of time value of money is material.

Discount rate:
- Pre-tax rate.
- Reflect current market and risks of the liability.
- Excludes risks included in cash flow estimates.
- Recognize borrowing cost over time.

Future events:
- Reflect if sufficient objective evidence of occurrence.
  - E.g. possible new legislation when virtually certain of enactment, future site restoration costs reduced by future changes in technology, etc.

Expected disposal of assets:
- Gains from expected disposal of assets are not reflected in provision.

Change in provisions:
- Reviewed at each reporting period to reflect current ***best estimate.***

RECOGNITION

PROVISIONS

Recognize only when:
- Entity has a ***present obligation*** (legal or constructive) as a result of a past event (i.e., **obligating event);**
- It is ***probable*** that an outflow of resources will be required to settle the obligation; AND
- A ***reliable estimate*** can be made of the amount.

OBLIGATING EVENT IN PAST

No realistic alternative to settling the obligation created by the past event:
- Settlement enforceable by law (**legal obligation**).
- The event creates valid expectations in other parties that the entity will discharge the obligation **(constructive obligation).**

PRESENT OBLIGATION

A past event is deemed to give rise to a ***present obligation*** if, taking account of all available evidence, it is more likely than not that a present obligation exists at the end of the reporting period.

When more likely that no present obligation exist = ***contingent liability.***

PROBABLE OUTFLOW

- **Probable** = more likely than not (i.e., > 50% probability) that there will be an outflow of resources embodying economic benefits.
- Consider the class of obligations as a whole (e.g. product warranties or similar controls).

When more likely that no outflow of resources = ***contingent liability.***

RELIABLE ESTIMATE

Except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognizing a provision.

When obligation amount not reliably estimated = ***contingent liability.***

CONTINGENT

Do not recognize!
- For each class, **disclose the following** (unless outflow in settlement is remote):
  - Description of the nature;
  - Estimate of financial effect;
  - Uncertainties relating to amount or timing of any outflow;
  - Possibility of reimbursement;
  - Impracticality to disclose the above (if applicable).
- **Reassess continually:**
  - **Recognize** as a provision when outflow becomes ***probable*** (more likely than not [i.e., >50% probability]).

CONTINGENT ASSETS

Do not recognize!
- If inflow of economic benefits probable, **disclose**:
  - Description of the nature
  - Estimate of financial effect
  - Impracticality to disclose the above (if applicable).
- E.g. claim legally pursued but outcome is uncertain.
- **Reassess continually:**
  - **Recognize** when inflow becomes virtually certain.
  - **Disclose** when inflow becomes ***probable.***

RESTRUCTURING

Constructive obligation only if:
- Detail formal plan identifying:
  - Business or part of business;
  - Principal locations affected;
  - Location, function and number of employees who will be compensated;
  - Expenditure to undertake;
  - Timing of the plan; and
- Raise a valid expectation in those affected through implementation or detailed announcement.

Provision includes only direct expenditure arising from the restructuring.

OTHER POINTS

- Reimbursements recognized as separate assets if virtually certain to be received and amount recognized shall not exceed provision.
- Provisions are not recognized for future operating losses.
- No restructuring obligation arises for the sale of an operation without a binding sale agreement with purchaser.
- Present obligation of onerous contracts recognized as provision.