

COURSE ON IFRS

PROVISIONS, CONTINGENT LIABILITIES, AND CONTINGENT ASSETS (IAS 37)

PRESENTATION BY :
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IAS 37 Applicability

The requirements of IAS 37 are applicable to recognition & measurement of all provisions, contingent liabilities, and contingent assets *except*

- (a) Those resulting from executory contracts except where the contract is onerous contracts
- (b) Those covered by other Standards

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Executory Contract

Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

This Standard does not apply to executory contracts unless they are onerous.

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Exclusion

- Construction contracts (IAS 11)
- Income taxes (IAS 12)
- Leases (IAS 17) (onerous leases are covered by IAS 37.)
- Employee benefits (IAS 19)
- Insurance contracts (IFRS 4) (However, IAS 37 still applies to other than those arising from its contractual obligations and rights under insurance contracts covered by IFRS 4.)
- **Financial instruments (including guarantees) that are within the scope of IAS 39.**

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Provision

liabilities that are of uncertain timing or amount are “provisions”

Whether following are provisions :

- Provision for Depreciation
- Provision for Bad Debts
- Provision for O/S Expenses
- Provision for Bonus
- Creditors

None of the above are provisions

Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

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Provision- Conditions

IFF all conditions are fulfilled : -

- a) An entity has a *present obligation resulting from a past obligating event*;
- (b) It is *probable that an outflow of resources embodying economic benefits would be required to settle the obligation*; and
- (c) A *reliable estimate can be made of the amount of the obligation*.

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Obligation –

An *obligating event* is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

Legal or Constructive Obligation

Legal Obligation : is an obligation that could

- (a) Be contractual; *or*
- (b) Arise due to a legislation; *or*
- (c) Result from other operation of law.

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Constructive Obligation

Constructive Obligation that results from an entity's actions where

- (a) By an established pattern of past practice, published policies, or a sufficiently specific current statement, the entity has indicated to other (third) parties that it will accept certain responsibilities;
- and*
- (b) As a result, the entity has created a valid expectation in the minds of those parties that it will discharge those responsibilities.

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Measurement of Provision

best estimate of the expenditure required to settle the present obligation at the balance sheet date

If not possible to obtain a reliable estimate then it is to be disclosed as Contingent Liab .

- ✓ *Best Estimate based on past experience*
- ✓ *If group of items > Expected Value*
- ✓ *If single item > Most likely outcome*

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Measurement of Provision

- Provision to be discounted to its PV
- Remeasure at each B/S Date
- No provision for the future operating losses
(However, impairment may be reqd)

Provision for an **onerous contract** where the unavoidable costs exceed the benefits expected (The excess unavoidable costs should be provided for at the time the contract becomes onerous)

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Constructive Obligation - Restructuring

A constructive obligation arises when, and only when, an entity

- Has a *detailed formal plan for the restructuring outlining at least the business or part of the business* being restructured; the principal locations affected by the restructuring; the location, function, and approximate number of employees who will be compensated for terminating their employment; when the plan will be implemented and the expenditures that will be undertaken; and
- Has raised valid expectations in the minds of those affected that the entity will carry out restructuring by starting to implement that plan or announcing its main features to those affected by it.

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Contingent Liability

A contingent liability is a *possible obligation arising from past events, the outcome of which will be confirmed only on the occurrence or nonoccurrence of one or more uncertain future events*. A contingent liability is also a *present obligation that is not recognized, either because it is not probable that an outflow of resources will be required to settle an obligation or the amount of the obligation cannot be measured with sufficient reliability*

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Contingent Assets

Contingent assets are *possible assets that arise from a past event and whose existence is confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the entity.*

Virtual Certainty required

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IFRIC 1 on IAS 37 (*Appendix A of Ind As 37*)

IFRIC 1 - *Changes in Existing Decommissioning, Restoration and Similar Liabilities. Unwinding of discount as Finance Cost*

- IFRIC 5 - contributor for interests arising from decommissioning funds. the contributor shall recognize its obligation to pay decommissioning costs as a liability and recognize its interest in the fund separately unless the contributor is not liable to pay decommissioning costs even if the fund fails to pay.
- IFRIC 6 - Waste Electrical and Electronic Equipment (WE & EE) . participation in the market during the measurement period," triggers the "obligating event"

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EXAMPLES

- Warranties
- Reimbursements
- Refund Policy
- Legal Requirement to fit Smoke Filters
- Staff Retraining as a result of changes in Tax
- Guarantees
- Onerous Contracts
- Refurbishment cost – Legal Requirements

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Questions ?????

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