



IAS 37 PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

FACT SHEET

This fact sheet is based on existing requirements as at 31 December 2015 and does not take into account recent standards and interpretations that have been issued but are not yet effective.

IMPORTANT NOTE

This fact sheet is based on the requirements of the International Financial Reporting Standards (IFRSs). In some jurisdictions, the IFRSs are adopted in their entirety; in other jurisdictions the individual IFRSs are amended. In some jurisdictions the requirements of a particular IFRS may not have been adopted. Consequently, users of the fact sheet in various jurisdictions should ascertain for themselves the relevance of the fact sheet to their particular jurisdiction. The application date included below is the effective date of the initial version of the standard.

IASB APPLICATION DATE (NON-JURISDICTION SPECIFIC)

IAS 37 is applicable for annual reporting periods commencing on or after 1 July 1999.

OBJECTIVE

IAS 37 ensures that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the notes to enable users to understand their nature, timing and amount.

SCOPE

IAS 37 shall be applied in accounting for provisions, contingent liabilities and contingent assets but does not apply to provisions, contingent liabilities and contingent assets:

- resulting from executory contracts, except where the contract is onerous (see definition); and
- covered by another standard (e.g. financial instruments (including guarantees), construction contracts, income taxes, employee benefits, insurance contracts and contingent consideration of an acquirer in a business combination).

RECOGNITION AND MEASUREMENT

Provisions

Provisions can be distinguished from other liabilities (e.g. trade payables and accruals) due to the uncertainty concerning the timing or amount of the future expenditure required in settlement.

In a general sense, all provisions are contingent because they are uncertain in timing or amount. However, within IAS 37 the term 'contingent' is used for liabilities and assets that are not recognised because their 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.

IAS 37 requires a provision be recognised when all of the following apply:

- an entity has a present obligation (legal or constructive) as a result of a past event
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation
- a reliable estimate can be made of the amount of the obligation

Provisions are measured at the best estimate of the expenditure required to settle the present obligation at the reporting period:

- including any considerations for risks and uncertainties
- including time value of money (if material)
- including future events when there is sufficient objective evidence that they will occur
- excluding gains from the expected disposal of assets

Provisions are to be reviewed at the end of each reporting period and adjusted to reflect the current best estimate.

The provision is reversed where it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

A provision is used only for expenditures for which the provision was originally recognised; i.e. only expenditures that relate to the original provision are set against it.

When some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised as a separate asset when, and only when, it is virtually certain that the reimbursement will be received if the entity settles the obligation. The maximum amount recognised as an asset is the amount of the provision.

IAS 37 stipulates that:

- A provision must not be recognised for future operating losses;
- If an entity has a contract that is onerous, the present obligation under the contract is recognised and measured as a provision; and
- A provision for restructuring costs can only be recognised if specific present obligation requirements are satisfied (e.g. details formal plan and the entity has raised a valid expectation in those affected).

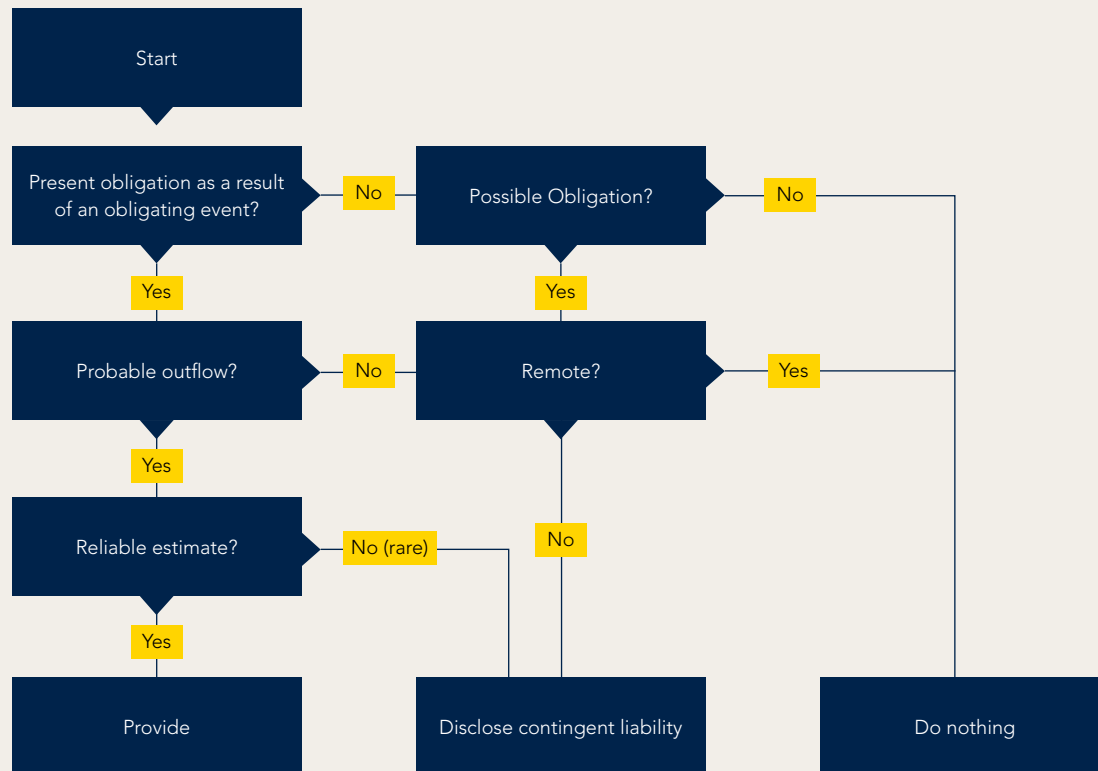
Note: The difference between a future operating loss and an onerous contract is in the present obligation. With an onerous contract, there is a committed obligation to deliver the customer at a loss. A future operating loss does not have the equivalent present obligation; e.g. no obligation to continue at a loss; expected loss has not eventuated.

Contingent Liabilities

IAS 37 prohibits recognition of contingent liabilities given that they are either:

- Possible obligations, as it has yet to be confirmed whether the entity has a present obligation that could lead to an outflow of resources embodying economic benefits; or
- Present obligations that do not meet the recognition criteria (because either it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made).

This diagram below summarises the main recognition requirements of IAS 37 for provisions and contingent liabilities:



Contingent Assets

IAS 37 prohibits the recognition of contingent assets since this may result in the recognition of income that may never be realised. Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the entity (e.g. a claim that an entity is pursuing through legal processes where the outcome is uncertain).

DISCLOSURES

Refer Appendix 1 for a checklist to assist with IAS 37 disclosure requirements.

DEFINITIONS

Constructive obligation	<p>An obligation that derives from an entity's actions where:</p> <ul style="list-style-type: none"> • By an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and • As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities
Contingent asset	<p>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.</p>
Contingent liability	<ul style="list-style-type: none"> • A possible obligation 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. • A present obligation that arises from past events but is not recognised because: <ul style="list-style-type: none"> – it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or – the amount of the obligation cannot be measured with sufficient reliability.
Legal obligation	<p>An obligation that derives from:</p> <ul style="list-style-type: none"> • a contract (through its explicit or implicit term); • legislation • other operation of law
Liability	<p>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.</p>
Obligating event	<p>An event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.</p>
Onerous contract	<p>A contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.</p>
Provision	<p>A liability of uncertain timing or amount.</p>
Restructuring	<p>A programme that is planned and controlled by management, and materially changes either:</p> <ul style="list-style-type: none"> • the scope of a business undertaken by the entity • the manner in which that business is conducted

RELATED INTERPRETATION

- IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*
- IFRIC 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*
- IFRIC 6 *Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment*
- IFRIC 21 *Levies*

IFRIC 21 is relatively more significant than the others. It addresses how an entity should account for liabilities to pay levies imposed by governments, other than income taxes, in its financial statements (in particular, when the entity should recognise a liability to pay a levy).

IFRIC 21 is an interpretation of IAS 37. IAS 37 sets out criteria for the recognition of a liability, one of which is the requirement for the entity to have a present obligation as a result of a past event (known as an obligating event). The Interpretation clarifies that the obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy. For example, if the activity that triggers the payment of the levy is the generation of revenue in the current period and the calculation of that levy is based on the revenue that was generated in a previous period, the obligating event for that levy is the generation of revenue in the current period. The generation of revenue in the previous period is necessary, but not sufficient, to create a present obligation.

AUSTRALIAN SPECIFIC REQUIREMENTS

The Australian equivalent standard is AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* and is applicable for annual reporting periods commencing on or after 1 January 2005. The Australian equivalent interpretations are:

- Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*
- Interpretation 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*
- Interpretation 6 *Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment*
- Interpretation 21 *Levies*

Recognition of liabilities arising from local government and government existing public policies, budget policies, election promises or Statements of Intent

The intention to make payments to other parties, whether advised in the form of a local government or government budget policy, election promise or statement of intent, does not of itself, create a present obligation which is binding.

A liability would be recognised only when the entity is committed in the sense that it has little or no discretion to avoid the sacrifice of future economic benefits.

Some such transactions or events may give rise to legal, social, political or economic consequences which leave little, if any, discretion to avoid a sacrifice of future economic benefits. In such circumstances, the definition of a liability is satisfied.

REDUCED DISCLOSURE REQUIREMENTS (RDR)

On 30 June 2010, the Australian Accounting Standards Board published AASB 1053 *Application of Tiers of Australian Accounting Standards* (and AASB 2010-2 *Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements*) which established a differential reporting framework, consisting of two Tiers of reporting requirements for preparing general purpose financial statements:

- Tier 1: Australian Accounting Standards; and
- Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements.

Tier 2 comprises the recognition, measurement and presentation requirements of Tier 1 and substantially reduced disclosures corresponding to those requirements.

A Tier 2 entity is a 'reporting entity' as defined in SAC 1 *Definition of the Reporting Entity* that does not have 'public accountability' as defined in AASB 1053 and is not otherwise deemed to be a Tier 1 entity by AASB 1053.

RDR is applicable to annual periods beginning on or after 1 July 2013.

The requirements that do not apply to RDR entities are identified in Appendix 1 by shading of the relevant text.

APPENDIX 1 – DISCLOSURE CHECKLIST

This checklist can be used to review your financial statements. You should complete the “Yes / No / N/A” column about whether the requirement is included. To ensure the completeness of disclosures, provide an explanation for “No” answers.

CODE		YES / NO / N/A	EXPLANATION (If required)
IAS 37.84	<p>Is the following information disclosed for each class of provision:</p> <ul style="list-style-type: none"> a. the carrying amount at the beginning and end of the period; b. additional provisions made in the period, including increases to existing provisions; c. amounts used (i.e. incurred and charged against the provision) during the period; d. unused amounts reversed during the period; and e. the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate. <p>Note: Comparative information is not required.</p>		
IAS 37.85	<p>Has the following information been disclosed for each class of provision:</p> <ul style="list-style-type: none"> a. a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits; b. an indication of the uncertainties about the amount or timing of those outflows – where necessary to provide adequate information, the entity should disclose the major assumptions made concerning future events as addressed in IAS 37.48; and c. the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement. 		
IAS 37.86	<p>Unless the possibility of any outflow in settlement is remote, has the entity disclosed for each class of contingent liability at the end of the reporting period, a brief description of the nature of the contingent liability and, where practicable:</p> <ul style="list-style-type: none"> a. an estimate of its financial effect, measured in accordance with the requirements for measuring provisions (under IAS 37.36 - IAS 37.52); b. an indication of the uncertainties relating to the amount or timing of any outflow; and c. the possibility of any reimbursement. 		

CODE		YES / NO / N/A	EXPLANATION (If required)
IAS 37.89	<p>When an inflow of economic benefits is probable, has the entity disclosed:</p> <ul style="list-style-type: none"> a. a brief description of the nature of the contingent assets at the end of the reporting period; and b. if practicable, an estimate of their financial effect, measured in accordance with the requirements for measuring provisions (under IAS 37.36 – IAS 37.52). 		
IAS 37.91	<p>Where any of the information required by IAS 37.86 and IAS 37.89 is not disclosed because it is not practicable to do so, has this fact been stated?</p>		
IAS 37.92	<p>In extremely rare cases, disclosure of some or all of the information required regarding provisions, contingent liabilities or contingent assets can be expected to prejudice seriously the position of the entity in a dispute with other parties. Where this is the case, has the entity disclosed:</p> <ul style="list-style-type: none"> a. the general nature of the dispute; and b. the fact that, and reason why, the information has not been disclosed. 		

OTHER MATTERS

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