ACCAspace
Professional Accounting Education

Provided by
ACCA Research Institute

ACCA F7

Financial Reporting(INT.)

财务报告（国际会计准则）

Chapter 6 IAS 37 Provision

ACCA Lecturer: Roy Wang

IAS 37　Provisions, contingent liabilities and contingent assets

1. Provision
2. Contingent liability
3. Contingent asset
4. Example

Provision

IAS 37 provision

A **provision** is a **liability** of uncertain timing or amount.

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.

IAS 37 provision

Recogenition (同时满足以下条件)

A:probable that resources will be transferred to settle the liability (asset/other resources);

B：present obligation whether it’s legal (law) or constructive (published information) from past event;

C:reliable estimate of the amount of payment can be made.

IAS 37 provision

E.g

a)Warranties

b)Environmental contamination

c)Decommissioning or abandonment costs

d)Restructuring

IAS 37 provision

It is fairly clear what a **legal obligation** is. However, you may not know what a **constructive obligation is.**

IAS 37 defines a **constructive obligation as** 'An obligation that derives from an entity's actions where:

•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.'

Measurement

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

IAS 37 provision

The estimates will be determined by the **judgement** of the entity's management supplemented by the experience of similar transactions.

Allowance is made for **uncertainty**. Where the provision being measured involves a large population of items, the obligation is estimated by **weighting** all possible outcomes by their associated probabilities, ie **expected value**.

Where the provision involves a single item, such as the outcome of a legal case, provision is made **in full** for the most likely outcome.

IAS 37 provision

Parker Co sells goods with a warranty under which customers are covered for the cost of repairs of any manufacturing defect that becomes apparent within the first six months of purchase. The company's past experience and future expectations indicate the following pattern of likely repairs.

% of goods sold	*Defects*	*Cost of repairs if all items suffered from these defects*
		$m
75	None	–
20	Minor	1.0
5	Major	4.0

Required

What is the provision required?

IAS 37 provision

Warranty

DR Expense (Statement of profit or loss and other comprehensive income)

CR Provision (Statement of financial position)

IAS 37 provision

Environmental contamination

Decommissioning or abandonment costs(discount)

- **DR Asset**
- **CR Provision**

IAS 37 provision

A company knows that when it ceases a certain operation in five years' time it will have to pay **environmental cleanup** costs of $5m.

The provision to be made now will be the present value of $5m in five years' time.The relevant discount rate in this case is 10%.

IAS 37 provision

$5m * 0.62092	3,104,600

*The discount rate for 5 years at 10%.

Provisions for restructuring

IAS 37 provision

The IAS gives the following examples of events that may fall under the definition of restructuring.

- The sale or termination of a line of business
- The closure of business locations in a country or region or the relocation of business activities from one country region to another
- Changes in management structure, for example, the elimination of a layer of management
- Fundamental reorganisations that have a material effect on the nature and focus of the entity's operations

IAS 37 provision

The question is whether or not an entity has an obligation – legal or constructive – at the end of the reporting period. For this to be the case:

- An entity must have a **detailed formal plan** for the restructuring
- It must have **raised a valid expectation** in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it

Costs to be included within a restructuring provision

The IAS states that a restructuring provision should include only the **direct expenditures** arising from the restructuring, which are those that are both:

Necessarily entailed by the restructuring; and

Not associated with the **ongoing activities** of the entity.

IAS 37 provision

The following costs should specifically **not** be included within a restructuring provision.

- **Retraining** or relocating continuing staff
- **Marketing**
- **Investment in new systems** and distribution networks

Contingent liability &

Contingent asset

IAS 37 CL&CA

- An entity should not **recognise** a contingent asset or liability, but they should be **disclosed.**

IAS 37 CL&CA

IAS 37 defines a **contingent liability as:**

- 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;

IAS 37 CL&CA

A present obligation that arises from past events but is not recognised because:

- – 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.

IAS 37 CL&CA

IAS 37 defines a **contingent asset as:**

- A possible asset that arises from past events and whose existence will be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within control of the entity.

.

IAS 37 CL&CA

- A contingent asset must not be recognised. Only when the **realisation** of the related economic benefits is **virtually certain** should recognition take place. At that point, the asset is no longer a contingent asset!

IAS 37 provision

On 1 October 2013, Xplorer commenced drilling for oil from an undersea oilfield. The extraction of oil causes damage to the seabed which has a restorative cost (ignore discounting) of $10,000 per million barrels of oil extracted. Xplorer extracted 250 million barrels of oil in the year ended 30 September 2014.

Xplorer is also required to dismantle the drilling equipment at the end of its five-year licence. This has an estimated cost of $30 million on 30 September 2018. Xplorer's cost of capital is 8% per annum and $1 has a present value of 68 cents in five years' time.

IAS 37 provision

What is the total provision (extraction plus dismantling) which Xplorer would report in its statement of financial position as at 30 September 2014 in respect of its oil operations?

A.$34,900,000

B.$24,532,000

C.$22,900,000

D.$4,132,000

ACCAspace

Professional Accounting Education

Provided by

ACCA Research Institute

Thank You!