NZ International Accounting Standard 37 (PBE)

Provisions, Contingent Liabilities and Contingent Assets (NZ IAS 37 (PBE))

Issued November 2012 excluding consequential amendments resulting from early adoption of NZ IFRS 9 (2010) (PBE) ***Financial Instruments***

This Standard was issued by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 24(1)(a) of the Financial Reporting Act 1993.

This Standard is a Regulation for the purposes of the Regulations (Disallowance) Act 1989.

As at 1 December 2012, the requirements in this Standard are identical to the requirements in NZ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* as applied by public benefit entities. Versions of NZ IAS 37 applied by public benefit entities prior to adoption of this Standard are available on the Archived Standards page of the External Reporting Board (XRB) website at xrb.govt.nz

The following New Zealand Interpretations refer to NZ IAS 37 (PBE):

- NZ SIC-27 (PBE) *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*
- NZ SIC-29 (PBE) *Service Concession Arrangements: Disclosures*
- NZ IFRIC 1 (PBE) *Changes in Decommissioning, Restoration and Similar Liabilities*
- NZ IFRIC 5 (PBE) *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*
- NZ IFRIC 6 (PBE) *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment*
- NZ IFRIC 12 (PBE) *Service Concession Arrangements*
- NZ IFRIC 13 (PBE) *Customer Loyalty Programmes*

- NZ IFRIC 14 (PBE) *NZ IAS 19* (PBE)—*The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*
- NZ IFRIC 15 (PBE) *Agreements for the Construction of Real Estate*

NZ IAS 37 (PBE)

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ISBN 978-1-927174-95-1

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NZ International Accounting Standard 37 (PBE) *Provisions, Contingent Liabilities and Contingent Assets* (NZ IAS 37 (PBE)) is set out in paragraphs NZ 0.1–NZ 96.1. NZ IAS 37 (PBE) is based on International Accounting Standard 37 *Provisions, Contingent Liabilities and Contingent Assets* (IAS 37) (1998) issued by the International Accounting Standards Committee (IASC) and adopted by the International Accounting Standards Board (IASB). All the paragraphs have equal authority but retain the IASC format of the Standard when it was adopted by the IASB. NZ IAS 37 (PBE) should be read in the context of its objective and Part B of the New Zealand *Conceptual Framework for Financial Reporting (PBE)* (NZ *Framework (PBE)*). NZ IAS 8 (PBE) *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Any additional material is shown with grey shading. The paragraphs are denoted with "NZ" and identify the types of entities to which the paragraphs apply.

This Standard uses the terminology adopted in International Financial Reporting Standards (IFRSs) to describe the financial statements and other elements. NZ IAS 1 (PBE) *Presentation of Financial Statements* paragraph 5 explains that entities other than profit-oriented entities seeking to apply the Standard may need to amend the descriptions used for particular line items in the financial statements and for the financial statements themselves. For example, profit/loss may be referred to as surplus/deficit and capital or share capital may be referred to as equity.

HISTORY OF AMENDMENTS

Table of Pronouncements – NZ IAS 37 (PBE) ***Provisions, Contingent Liabilities and Contingent Assets***

This table lists the pronouncement establishing NZ IAS 37 (PBE).

Pronouncements	**Date approved**	**Early operative date**	**Effective date (annual reporting periods… on or after …)**
NZ IAS 37 (PBE) *Provisions, Contingent Liabilities and Contingent Assets*	Nov 2012	Early application permitted	1 Dec 2012

Table of Amended Paragraphs in NZ IAS 37 (PBE)		
Paragraph affected	**How affected**	**By … [date]**
Paragraph NZ 0.1	Inserted	NZ IAS 37 (PBE) [Nov 2012]
Paragraphs 95–96	Deleted	NZ IAS 37 (PBE) [Nov 2012]
Paragraph NZ 96.1	Inserted	NZ IAS 37 (PBE) [Nov 2012]

The following tables list the pronouncements establishing and substantially amending NZ IAS 37 as applied by PBEs prior to the issue of this Standard as NZ IAS 37 (PBE) other than consequential amendments resulting from early adoption of NZ IFRS 9 (2010) *Financial Instruments.*

Pronouncements	**Date approved**	**Early operative date**	**Effective date (annual reporting periods… on or after …)**
NZ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*	Nov 2004	1 Jan 2005	1 Jan 2007
Framework for Differential Reporting for Entities Applying the New Zealand Equivalents to IFRSs Financial Reporting Standards Reporting Regime (Framework for Differential Reporting)	June 2005	1 Jan 2005	1 Jan 2007

Pronouncements	**Date approved**	**Early operative date**	**Effective date (annual reporting periods… on or after …)**
Amendment to the *Framework for Differential Reporting*	Dec 2005	1 Jan 2005	1 Jan 2007
NZ IAS 1 *Presentation of Financial Statements* (revised 2007)	Nov 2007	Early application permitted	1 Jan 2009
NZ IFRS 3 *Business Combinations* (revised 2008)	Feb 2008	Early application permitted	1 Jan 2009
Minor Amendments to NZ IFRSs (2008-1)	April 2008	Early application permitted	1 June 2008
Minor Amendments to NZ IFRSs	July 2010	Immediate	Immediate

Table of Amended Paragraphs in NZ IAS 37		
Paragraph affected	**How affected**	**By … [date]**
Paragraph 5	Amended	NZ IFRS 3 [Feb 2008]
Paragraph NZ 9.1	Inserted	Amendment to the *Framework for Differential Reporting* [Dec 2005]
Paragraph 89	Amended	Minor Amendments (2008-1) [April 2008]

Introduction to NZ IAS 37 (PBE)

NZ IAS 37 (PBE) is identical to NZ IAS 37 applied by public benefit entities prior to the issuance of NZ IAS 37 (PBE). That is, there are no changes to the recognition, measurement, presentation and disclosure requirements of NZ IAS 37 on adoption of this Standard.

NZ IAS 37 (PBE) prescribes the accounting and disclosure for all provisions, contingent liabilities and contingent assets, except:

(a) those resulting from executory contracts, except where the contract is onerous. 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; and

(b) those covered by another Standard.

In addition, NZ IAS 37 (PBE) excludes from its scope certain obligations of the Crown.

Provisions

The Standard:

(a) defines provisions;

(b) defines a constructive obligation;

(c) establishes requirements entities should take into account in measuring provisions;

(d) requires provisions to be reviewed at the end of each reporting period and adjusted to reflect the current best estimate; and

(e) states that a provision is to be used only for expenditures for which the provision was originally recognised.

Contingent liabilities

The Standard:

(a) defines a contingent liability;

(b) prohibits recognition of contingent liabilities; and

(c) requires disclosure of contingent liabilities, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets

The Standard:

(a) defines a contingent asset;

(b) does not permit an entity to recognise a contingent asset;

(c) requires disclosure of contingent assets where an inflow of economic benefits is probable; and

(d) states that when the realisation of income is virtually certain, the related asset is not a contingent asset and its recognition is appropriate.

When IAS 37 was introduced to New Zealand for public benefit entities the following changes were made to IAS 37. NZ IAS 37 (PBE):

(a) defines the term public benefit entities (paragraph NZ 10.1);

(b) excludes from the scope of the Standard certain obligations of the Crown and provides guidance on these obligations (paragraphs NZ 1.1 and NZ 3.1 to NZ 3.3); and

(c) includes additional examples applicable to public benefit entities in Appendix E.

Differential reporting

Qualifying entities are given several concessions to the requirements of this Standard (as identified in the Standard).

NZ International Accounting Standard 37 (PBE)

Provisions, Contingent Liabilities and Contingent Assets (NZ IAS 37 (PBE))

Objective

The objective of this Standard is to ensure 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

NZ 0.1 This Standard applies only to public benefit entities.

1 **This Standard shall be applied by all entities in accounting for provisions, contingent liabilities and contingent assets, except:**

(a) **those resulting from executory contracts, except where the contract is onerous; and**

(b) [deleted by IASB]

(c) **those covered by another Standard.**

The Crown

NZ 1.1 This Standard shall be applied by all entities in accounting for provisions, contingent liabilities and contingent assets except in the case of the Crown. In the case of the Crown this Standard shall not be applied in accounting for obligations expressed in legislation that have characteristics similar to an executory contract.

2 This Standard does not apply to financial instruments (including guarantees) that are within the scope of NZ IAS 39 (PBE) *Financial Instruments: Recognition and Measurement.*

3 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.

The Crown

NZ 3.1 Obligations of the Crown expressed in legislation that have characteristics similar to an executory contract are those where:

(a) the Crown is obligated to provide goods, services or transfers to the community in future periods using funding to be obtained from the community substantially in those future periods; and

(b) the intended third party recipients of the goods, services or transfers have not yet satisfied the criteria for entitlement to those goods, services or transfers.

NZ 3.2 These obligations of the Crown have characteristics similar to executory contracts in that the community will, collectively, provide funds to the Crown in the future under tax legislation, and the Crown will, in return, provide goods, services or transfers to the community in the future. Such obligations of the Crown include obligations to make future social welfare payments (such as to pay unemployment, domestic purposes and national superannuation benefits) and to deliver future health and education services, to the extent that the substantial funding of those benefits will be met through future taxation and other revenues and the intended recipients have not already satisfied the criteria for entitlement to those benefits. However, such obligations exclude the obligation of the Crown to fund future payments by the Government Superannuation Fund since the recipients of those future payments have already performed services giving rise to obligations.

NZ 3.3 The exclusion from the application of this Standard of obligations of the Crown that have characteristics similar to an executory contract is not intended to achieve a different result, in terms of the Crown's recognition of liabilities, from the practice followed at the date of introduction of this Standard to recognise liabilities only where the recipients of benefits to be provided in the future have already satisfied the criteria for entitlement to those benefits. These obligations raise issues for financial reporting that require further study. Therefore, until further progress has been made in this regard, such obligations of the Crown are excluded from the scope of this Standard.

4 [Deleted by IASB]

5 When another Standard deals with a specific type of provision, contingent liability or contingent asset, an entity applies that Standard instead of this Standard. For example, some types of provisions are also addressed in Standards on:

(a) construction contracts (see NZ IAS 11 (PBE) *Construction Contracts*);

(b) income taxes (see NZ IAS 12 (PBE) *Income Taxes*);

(c) leases (see NZ IAS 17 (PBE) *Leases*). However, as NZ IAS 17 (PBE) contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases;

(d) employee benefits (see NZ IAS 19 (PBE) *Employee Benefits*); and

(e) insurance contracts (see NZ IFRS 4 (PBE) *Insurance Contracts*). However, this Standard applies to provisions, contingent liabilities and contingent assets of an insurer, other than those arising from its contractual obligations and rights under insurance contracts within the scope of NZ IFRS 4 (PBE)

6 Some amounts treated as provisions may relate to the recognition of revenue, for example where an entity gives guarantees in exchange for a fee. This Standard does not address the recognition of revenue. NZ IAS 18 (PBE) *Revenue* identifies the circumstances in which revenue is recognised and provides practical guidance on the application of the recognition criteria. This Standard does not change the requirements of NZ IAS 18 (PBE).

7 This Standard defines provisions as liabilities of uncertain timing or amount. In some countries the term ‘provision’ is also used in the context of items such as depreciation, impairment of assets and doubtful debts: these are adjustments to the carrying amounts of assets and are not addressed in this Standard.

8 Other Standards specify whether expenditures are treated as assets or as expenses. These issues are not addressed in this Standard. Accordingly, this Standard neither prohibits nor requires capitalisation of the costs recognised when a provision is made.

9 This Standard applies to provisions for restructurings (including discontinued operations). When a restructuring meets the definition of a discontinued operation, additional disclosures may be required by NZ IFRS 5 (PBE) *Non-current Assets Held for Sale and Discontinued Operations*.

Qualifying Entities

NZ 9.1 Entities which qualify for differential reporting concessions in accordance with XRB A1 *Accounting Standards Framework* are not required to comply with the disclosure requirements in this Standard denoted with an asterisk (*).

Definitions

10 The following terms are used in this Standard with the meanings specified:

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.

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.

A *legal obligation* is an obligation that derives from:

(a) a contract (through its explicit or implicit terms);

(b) legislation; or

(c) other operation of law.

A *constructive obligation* is an obligation that derives 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 parties that it will accept certain responsibilities; and

(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

A contingent liability is:

(a) 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; or

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) the amount of the obligation cannot be measured with sufficient reliability.

A *contingent asset* is 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 entity.

An *onerous contract* is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

A *restructuring* is a programme that is planned and controlled by management, and materially changes either:

(a) the scope of a business undertaken by an entity; or

(b) the manner in which that business is conducted.

Public Benefit Entities

NZ 10.1 The following term is used in this Standard with the meaning specified:

***Public benefit entities* are reporting entities whose primary objective is to provide goods and services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.**

Provisions and other liabilities

11 Provisions can be distinguished from other liabilities such as trade payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. By contrast:

(a) trade payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier; and

(b) accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to accrued vacation pay). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

Accruals are often reported as part of trade and other payables, whereas provisions are reported separately.

Relationship between provisions and contingent liabilities

12 In a general sense, all provisions are contingent because they are uncertain in timing or amount. However, within this Standard 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. In addition, the term ‘contingent liability’ is used for liabilities that do not meet the recognition criteria.

13 This Standard distinguishes between:

(a) provisions - which are recognised as liabilities (assuming that a reliable estimate can be made) because they are present obligations and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations; and

(b) contingent liabilities - which are not recognised as liabilities because they are either:

(i) 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

(ii) present obligations that do not meet the recognition criteria in this Standard (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).

Recognition

Provisions

14 **A provision shall be recognised when:**

(a) **an entity has a present obligation (legal or constructive) as a result of a past event;**

(b) **it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and**

(c) **a reliable estimate can be made of the amount of the obligation.**

If these conditions are not met, no provision shall be recognised.

Present obligation

15 **In rare cases it is not clear whether there is a present obligation. In these cases, 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.**

16 In almost all cases it will be clear whether a past event has given rise to a present obligation. In rare cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an entity determines whether a present obligation exists at the end of the reporting period by taking account of all available evidence, including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the reporting period. On the basis of such evidence:

(a) where it is more likely than not that a present obligation exists at the end of the reporting period, the entity recognises a provision (if the recognition criteria are met); and

(b) where it is more likely that no present obligation exists at the end of the reporting period, the entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 86).

Past event

17 A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only:

(a) where the settlement of the obligation can be enforced by law; or

(b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation.

18 Financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an entity's statement of financial position are those that exist at the end of the reporting period.

19 It is only those obligations arising from past events existing independently of an entity's future actions (i.e. the future conduct of its business) that are recognised as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the entity. Similarly, an entity recognises a provision for the decommissioning costs of an oil installation or a nuclear power station to the extent that the entity is obliged to rectify damage already caused. In contrast, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.

20 An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed – indeed the obligation may be to the public at large. Because an obligation always involves a commitment to another party, it follows that a management or board decision does not give rise to a constructive obligation at the end of the reporting period unless the decision has been communicated before the end of the reporting period to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities.

21 An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law or because an act (for example, a sufficiently specific public statement) by the entity gives rise to a constructive obligation. For example, when environmental damage is caused there may be no obligation to remedy the consequences. However, the causing of the damage will become an obligating event when a new law requires the existing damage to be rectified or when the entity publicly accepts responsibility for rectification in a way that creates a constructive obligation.

22 Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted as drafted. For the purpose of this Standard, such an obligation is treated as a legal obligation. Differences in circumstances surrounding enactment make it impossible to specify a single event that would make the enactment of a law virtually certain. In many

cases it will be impossible to be virtually certain of the enactment of a law until it is enacted.

Probable outflow of resources embodying economic benefits

23 For a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. For the purpose of this Standard[*], an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, i.e. the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 86).

24 Where there are a number of similar obligations (e.g. product warranties or similar contracts) the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Although the likelihood of outflow for any one item may be small, it may well be probable that some outflow of resources will be needed to settle the class of obligations as a whole. If that is the case, a provision is recognised (if the other recognition criteria are met).

Reliable estimate of the obligation

25 The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which by their nature are more uncertain than most other items in the statement of financial position. 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 recognising a provision.

26 In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognised. That liability is disclosed as a contingent liability (see paragraph 86).

Contingent liabilities

27 An entity shall not recognise a contingent liability.

28 A contingent liability is disclosed, as required by paragraph 86, unless the possibility of an outflow of resources embodying economic benefits is remote.

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[*] The interpretation of ‘probable’ in this Standard as ‘more likely than not’ does not necessarily apply in other Standards.

29 Where an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. The entity recognises a provision for the part of the obligation for which an outflow of resources embodying economic benefits is probable, except in the extremely rare circumstances where no reliable estimate can be made.

30 Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs (except in the extremely rare circumstances where no reliable estimate can be made).

Contingent assets

31 An entity shall not recognise a contingent asset.

32 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. An example is a claim that an entity is pursuing through legal processes, where the outcome is uncertain.

33 Contingent assets are not recognised in financial statements since this may result in the recognition of income that may never be realised. However, when the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.

34 A contingent asset is disclosed, as required by paragraph 89, where an inflow of economic benefits is probable.

35 Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an entity discloses the contingent asset (see paragraph 89).

Measurement

Best estimate

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

37 The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the end of the

reporting period or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an obligation at the end of the reporting period. However, the estimate of the amount that an entity would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

38 The estimates of outcome and financial effect are determined by the judgement of the management of the entity, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered includes any additional evidence provided by events after the reporting period.

39 Uncertainties surrounding the amount to be recognised as a provision are dealt with by various means according to the circumstances. Where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities. The name for this statistical method of estimation is 'expected value'. The provision will therefore be different depending on whether the probability of a loss of a given amount is, for example, 60 per cent or 90 per cent. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.

Example

An entity sells goods with a warranty under which customers are covered for the cost of repairs of any manufacturing defects that become apparent within the first six months after purchase. If minor defects were detected in all products sold, repair costs of 1 million would result. If major defects were detected in all products sold, repair costs of 4 million would result. The entity's past experience and future expectations indicate that, for the coming year, 75 per cent of the goods sold will have no defects, 20 per cent of the goods sold will have minor defects and 5 per cent of the goods sold will have major defects. In accordance with paragraph 24, an entity assesses the probability of an outflow for the warranty obligations as a whole.

The expected value of the cost of repairs is:

(75% of nil) + (20% of 1m) + (5% of 4m) = 400,000

40 Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the entity considers other possible outcomes. Where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount. For example, if an entity has to rectify a serious fault in a major plant that it has constructed for a customer, the individual most likely outcome may be for the repair to succeed at the first attempt at a cost of 1,000, but a provision for a larger amount is made if there is a significant chance that further attempts will be necessary.

41 The provision is measured before tax, as the tax consequences of the provision, and changes in it, are dealt with under NZ IAS 12 (PBE).

Risks and uncertainties

42 The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision.

43 Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgements under conditions of uncertainty, so that income or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.

44 Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph 85(b).

Present value

45 Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation.

46 Because of the time value of money, provisions relating to cash outflows that arise soon after the reporting period are more onerous than those where cash outflows of the same amount arise later. Provisions are therefore discounted, where the effect is material.

47 The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) shall not reflect risks for which future cash flow estimates have been adjusted.

Future events

48 Future events that may affect the amount required to settle an obligation shall be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.

49 Expected future events may be particularly important in measuring provisions. For example, an entity may believe that the cost of cleaning up a site at the end of its life will be reduced by future changes in technology. The amount recognised reflects a reasonable expectation of technically qualified, objective observers, taking account of all available evidence as to the technology that will be available at the time of the clean-up. Thus it is appropriate to include, for example,

expected cost reductions associated with increased experience in applying existing technology or the expected cost of applying existing technology to a larger or more complex clean-up operation than has previously been carried out. However, an entity does not anticipate the development of a completely new technology for cleaning up unless it is supported by sufficient objective evidence.

50 The effect of possible new legislation is taken into consideration in measuring an existing obligation when sufficient objective evidence exists that the legislation is virtually certain to be enacted. The variety of circumstances that arise in practice makes it impossible to specify a single event that will provide sufficient, objective evidence in every case. Evidence is required both of what legislation will demand and of whether it is virtually certain to be enacted and implemented in due course. In many cases sufficient objective evidence will not exist until the new legislation is enacted.

Expected disposal of assets

51 Gains from the expected disposal of assets shall not be taken into account in measuring a provision.

52 Gains on the expected disposal of assets are not taken into account in measuring a provision, even if the expected disposal is closely linked to the event giving rise to the provision. Instead, an entity recognises gains on expected disposals of assets at the time specified by the New Zealand International Accounting Standard dealing with the assets concerned.

Reimbursements

53 Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement shall be treated as a separate asset. The amount recognised for the reimbursement shall not exceed the amount of the provision.

54 In the statement of comprehensive income, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.

55 Sometimes, an entity is able to look to another party to pay part or all of the expenditure required to settle a provision (for example, through insurance contracts, indemnity clauses or suppliers' warranties). The other party may either reimburse amounts paid by the entity or pay the amounts directly.

56 In most cases the entity will remain liable for the whole of the amount in question so that the entity would have to settle the full amount if the third party failed to pay for any reason. In this situation, a provision is recognised for the full amount of the liability, and a separate asset for the expected reimbursement is recognised when it

is virtually certain that reimbursement will be received if the entity settles the liability.

57 In some cases, the entity will not be liable for the costs in question if the third party fails to pay. In such a case the entity has no liability for those costs and they are not included in the provision.

58 As noted in paragraph 29, an obligation for which an entity is jointly and severally liable is a contingent liability to the extent that it is expected that the obligation will be settled by the other parties.

Changes in provisions

59 Provisions shall be reviewed at the end of each reporting period and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision shall be reversed.

60 Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognised as borrowing cost.

Use of provisions

61 A provision shall be used only for expenditures for which the provision was originally recognised.

62 Only expenditures that relate to the original provision are set against it. Setting expenditures against a provision that was originally recognised for another purpose would conceal the impact of two different events.

Application of the recognition and measurement rules

Future operating losses

63 Provisions shall not be recognised for future operating losses.

64 Future operating losses do not meet the definition of a liability in paragraph 10 and the general recognition criteria set out for provisions in paragraph 14.

65 An expectation of future operating losses is an indication that certain assets of the operation may be impaired. An entity tests these assets for impairment under NZ IAS 36 (PBE) *Impairment of Assets*.

Onerous contracts

66 **If an entity has a contract that is onerous, the present obligation under the contract shall be recognised and measured as a provision.**

67 Many contracts (for example, some routine purchase orders) can be cancelled without paying compensation to the other party, and therefore there is no obligation. Other contracts establish both rights and obligations for each of the contracting parties. Where events make such a contract onerous, the contract falls within the scope of this Standard and a liability exists which is recognised. Executory contracts that are not onerous fall outside the scope of this Standard.

68 This Standard defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.

69 Before a separate provision for an onerous contract is established, an entity recognises any impairment loss that has occurred on assets dedicated to that contract (see NZ IAS 36 (PBE)).

Restructuring

70 The following are examples of events that may fall under the definition of restructuring:

(a) sale or termination of a line of business;

(b) the closure of business locations in a country or region or the relocation of business activities from one country or region to another;

(c) changes in management structure, for example, eliminating a layer of management; and

(d) fundamental reorganisations that have a material effect on the nature and focus of the entity's operations.

71 A provision for restructuring costs is recognised only when the general recognition criteria for provisions set out in paragraph 14 are met. Paragraphs 72–83 set out how the general recognition criteria apply to restructurings.

72 **A constructive obligation to restructure arises only when an entity:**

(a) has a detailed formal plan for the restructuring identifying at least:

(i) the business or part of a business concerned;

(ii) the principal locations affected;

(iii) the location, function, and approximate number of employees who will be compensated for terminating their services;

(iv) the expenditures that will be undertaken; and

(v) **when the plan will be implemented; and**

(b) has 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.

73 Evidence that an entity has started to implement a restructuring plan would be provided, for example, by dismantling plant or selling assets or by the public announcement of the main features of the plan. A public announcement of a detailed plan to restructure constitutes a constructive obligation to restructure only if it is made in such a way and in sufficient detail (i.e. setting out the main features of the plan) that it gives rise to valid expectations in other parties such as customers, suppliers and employees (or their representatives) that the entity will carry out the restructuring.

74 For a plan to be sufficient to give rise to a constructive obligation when communicated to those affected by it, its implementation needs to be planned to begin as soon as possible and to be completed in a timeframe that makes significant changes to the plan unlikely. If it is expected that there will be a long delay before the restructuring begins or that the restructuring will take an unreasonably long time, it is unlikely that the plan will raise a valid expectation on the part of others that the entity is at present committed to restructuring, because the timeframe allows opportunities for the entity to change its plans.

75 A management or board decision to restructure taken before the end of the reporting period does not give rise to a constructive obligation at the end of the reporting period unless the entity has, before the reporting period:

(a) started to implement the restructuring plan; or

(b) announced the main features of the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will carry out the restructuring.

If an entity starts to implement a restructuring plan, or announces its main features to those affected, only after the reporting period, disclosure is required under NZ IAS 10 (PBE) *Events after the Reporting Period*, if the restructuring is material and non-disclosure could influence the economic decisions that users make on the basis of the financial statements.

76 Although a constructive obligation is not created solely by a management decision, an obligation may result from other earlier events together with such a decision. For example, negotiations with employee representatives for termination payments, or with purchasers for the sale of an operation, may have been concluded subject only to board approval. Once that approval has been obtained and communicated to the other parties, the entity has a constructive obligation to restructure, if the conditions of paragraph 72 are met.

77 In some countries, the ultimate authority is vested in a board whose membership includes representatives of interests other than those of management (e.g. employees) or notification to such representatives may be necessary before the board decision is taken. Because a decision by such a board involves

communication to these representatives, it may result in a constructive obligation to restructure.

78 **No obligation arises for the sale of an operation until the entity is committed to the sale, i.e. there is a binding sale agreement.**

79 Even when an entity has taken a decision to sell an operation and announced that decision publicly, it cannot be committed to the sale until a purchaser has been identified and there is a binding sale agreement. Until there is a binding sale agreement, the entity will be able to change its mind and indeed will have to take another course of action if a purchaser cannot be found on acceptable terms. When the sale of an operation is envisaged as part of a restructuring, the assets of the operation are reviewed for impairment, under NZ IAS 36 (PBE). When a sale is only part of a restructuring, a constructive obligation can arise for the other parts of the restructuring before a binding sale agreement exists.

80 **A restructuring provision shall include only the direct expenditures arising from the restructuring, which are those that are both:**

(a) **necessarily entailed by the restructuring; and**

(b) **not associated with the ongoing activities of the entity.**

81 A restructuring provision does not include such costs as:

(a) retraining or relocating continuing staff;

(b) marketing; or

(c) investment in new systems and distribution networks.

These expenditures relate to the future conduct of the business and are not liabilities for restructuring at the end of the reporting period. Such expenditures are recognised on the same basis as if they arose independently of a restructuring.

82 Identifiable future operating losses up to the date of a restructuring are not included in a provision, unless they relate to an onerous contract as defined in paragraph 10.

83 As required by paragraph 51, gains on the expected disposal of assets are not taken into account in measuring a restructuring provision, even if the sale of assets is envisaged as part of the restructuring.

Disclosure

84 **For each class of provision, an entity shall disclose:**

(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.**

Comparative information is not required.

85 An entity shall disclose the following for each class of provision:

(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, an entity shall disclose the major assumptions made concerning future events, as addressed in paragraph 48; and

(c) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

86 Unless the possibility of any outflow in settlement is remote, an entity shall disclose 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:

(a) an estimate of its financial effect, measured under paragraphs 36–52;

(b) an indication of the uncertainties relating to the amount or timing of any outflow; and

(c) the possibility of any reimbursement.

87 In determining which provisions or contingent liabilities may be aggregated to form a class, it is necessary to consider whether the nature of the items is sufficiently similar for a single statement about them to fulfil the requirements of paragraphs 85(a) and (b) and 86(a) and (b). Thus, it may be appropriate to treat as a single class of provision amounts relating to warranties of different products, but it would not be appropriate to treat as a single class amounts relating to normal warranties and amounts that are subject to legal proceedings.

88 Where a provision and a contingent liability arise from the same set of circumstances, an entity makes the disclosures required by paragraphs 84–86 in a way that shows the link between the provision and the contingent liability.

89 Where an inflow of economic benefits is probable, an entity shall disclose a brief description of the nature of the contingent assets at the end of the reporting period, and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs 36–52.

90 It is important that disclosures for contingent assets avoid giving misleading indications of the likelihood of income arising.

91 Where any of the information required by paragraphs 86 and 89 is not disclosed because it is not practicable to do so, that fact shall be stated.

92 **In extremely rare cases, disclosure of some or all of the information required by paragraphs 84–89 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.**

Transitional provisions

93 [Paragraph 93 is not reproduced. The transitional provisions in IAS 37 are not relevant to the adoption of this Standard.]

94 [Deleted by IASB]

Effective date

95–96 [Deleted]

NZ 96.1 This Standard applies to annual periods beginning on or after 1 December 2012. Early application is permitted. This Standard replaces NZ IAS 37 as applied by public benefit entities prior to the issuance of this Standard. There are no changes to the requirements of NZ IAS 37 as applied by public benefit entities.

Appendix E
New Zealand Examples: Recognition

This appendix accompanies, but does not form part of NZ IAS 37 (PBE). Examples 1 and 2 were developed to provide guidance applicable specifically to public benefit entities.

In all cases, it is assumed that a reliable estimate can be made of any outflows expected.

The appendix should be read in the context of the full text of NZ IAS 37 (PBE).

References to 'best estimate' are to the present value amount, where the effect of the time value of money is material.

Public Benefit Entities

Example 1: Non-Discretionary Grant

Public Sector Entity XYZ provides development grants (Type A grants) to encourage new businesses. Public Sector Entity XYZ has a policy to pay Type A grants (of a minimum amount of 10,000) on receipt of an application which is shown to meet various criteria. Public Sector Entity XYZ's policy of always providing Type A grants and the application criteria for Type A grants are generally known. Public Sector Entity XYZ cannot refuse to pay the grant if the applicant has met the criteria.

The end of Public Sector Entity XYZ's reporting period is 30 June. On 30 June 2000, Department M of Public Sector Entity XYZ had received 10 applications for a Type A grant but had not yet made a decision as to the amount of the grants that will be paid to the applicants. Based on past experience, Public Sector Entity XYZ expects to pay a total of 2,000,000 to the applicants.

Present obligation as a result of a past obligating event – The obligating event is the receipt of an application for a Type A grant that meets the application criteria. A legal obligation exists because Public Sector Entity XYZ has stated that it will pay the grant to those applicants that meet the criteria.

An outflow of resources embodying economic benefits in settlement – Payment of the grants is probable as at 30 June 2000.

Conclusion – At 30 June 2000, Public Sector Entity XYZ recognises a provision for the best estimate of the grants (see paragraph 14).

Example 2: Discretionary Grant

Public Sector Entity XYZ provides development grants (Type B grants) to encourage new businesses. When an application for a Type B grant is received, a committee considers it for approval. The committee has complete discretion as to whether the grant should be paid.

(a) Applicant notified prior to the balance date

On 15 June 2000, Department M received an application for a Type B grant. Prior to the end of the reporting period (30 June 2000) a committee approved payment of the grant. However, a decision regarding the amount of the grant had not been made. Based on the grants paid to previous applicants, the committee expected that the amount of the grant would be 50,000. The committee's decision to pay the grant (excluding the amount) was communicated to the applicant on 20 June 2000.

Present obligation as a result of a past obligating event – The obligating event is the communication of the committee's decision to pay the grant. A constructive obligation exists because Public Sector Entity XYZ has created a valid expectation on the part of the applicant that Department M will pay the grant.

Conclusion – A provision is recognised for the best estimate of the grant in Public Sector Entity XYZ's 30 June 2000 financial statements (see paragraphs 14 and 17-19).

(b) Applicant notified after the end of the reporting period

On 15 June 2000, Department M received an application for a Type B grant. After the end of the reporting period (30 June 2000) a committee approved payment of the grant and the committee's decision to pay the grant was communicated to the applicant.

Present obligation as a result of a past obligating event – There has been no obligating event and so there is no obligation.

Conclusion – No provision is recognised (see paragraph 14).