Institute of Chartered Accountants of New Zealand

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PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

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This Financial Reporting Standard replaces SSAP-15: Accounting for Contingencies (1982), although SSAP-15 will continue to apply to general purpose financial reports until an entity elects to comply with this Standard as permitted by the Financial Reporting Act 1993 section 27(7), or until this Standard takes effect, whichever is sooner.

This Financial Reporting Standard should be read in the context of the Explanatory Foreword to General Purpose Financial Reporting issued by the Council,
Institute of Chartered Accountants of New Zealand.

The Accounting Standards Review Board has approved FRS-15: Provisions, Contingent Liabilities and Contingent Assets, for the purposes of the Financial Reporting Act 1993, to apply to the following entities (as respectively defined in the Act): All reporting entities and groups, the Crown and all departments, Offices of Parliament and Crown entities and all local authorities.

1 INTRODUCTION

COMMENTARY

1.1 This Standard deals with the treatment of provisions, contingent liabilities and contingent assets in the financial report.

1.2 Financial reporting standards are paragraphs in bold type-face in this Standard. Where appropriate, interpretative commentary paragraphs in plain type-face follow the financial reporting standard.

2 APPLICATION

STANDARD

2.1. This Standard applies to the general purpose financial reports of all entities, except when exempted in paragraphs 2.2 and 2.3.

2.2 This Standard must be applied by all entities in accounting for provisions, contingent liabilities and contingent assets, except:

(a) those resulting from financial instruments that are carried at fair value;

(b) those resulting from executory contracts, except where the contract is onerous; and, additionally, in the case of the Crown, those obligations expressed in legislation that have characteristics similar to an executory contract;

(c) those arising in insurance entities from contracts with policyholders;

(d) those arising from employee benefits; and

(e) those covered by another Financial Reporting Standard.

2.3 Entities which qualify for exemption in accordance with the *Framework for Differential Reporting* are not required to make disclosures in their financial statements of the requirements in this Standard denoted with an asterisk(*).

COMMENTARY

2.4 This Standard applies to financial instruments (including guarantees) that are not carried at fair value.

2.5 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.

2.6 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.

These obligations of the Crown have charactersistics 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 those 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 obligations.

2.7 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.

2.8 This Standard applies to provisions, contingent liabilities and contingent assets of insurance entities other than those arising from contracts with policyholders.

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

(a) construction contracts (see FRS-14: *Accounting for Construction Contracts*);

(b) income taxes (see SSAP-12: *Accounting for Income Tax*);

(c) leases (see SSAP-18: *Accounting for Leases and Hire Purchase Contracts*). However, as SSAP-18 contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases; and

(d) insurance activities (see FRS-35: *Financial Reporting of Insurance Activities*).

2.10 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.

2.11 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.

2.12 Other Financial Reporting 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.

2.13 This Standard applies to provisions for restructuring (including discontinuing operations).

STANDARD

2.14 The financial reporting standards set out in this Standard apply to all financial reports where such application is of material consequence. A statement, fact, or item is material if it is of such a nature or amount that its disclosure, or the method of treating it, given full consideration of the circumstances applying at the time the financial report is completed, is likely to influence the users of the financial report in making decisions or assessments.

2.15 This Standard applies to general purpose financial reports covering periods ending on or after 31 October 2001.

3 STATEMENT OF PURPOSE

COMMENTARY

3.1 The purpose 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 the financial statements to enable users to understand their nature, timing and amount.

4 DEFINITIONS

STANDARD

The following terms are used in this Standard with these meanings:

4.1 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.

4.2 A "contingent asset" is:

(a) 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; or

(b) an asset that is not recognised because:

(i) it is not probable that the economic benefits embodied in the asset will eventuate; or

(ii) the asset possesses a cost or other value that cannot be measured reliably.

4.3 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 reliably.

COMMENTARY

4.4 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 reliable estimate of the amount of the obligation cannot be made).

4.5 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" is used for liabilities and assets that do not meet the recognition criteria.

STANDARD

4.6 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.

4.7 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.

4.8 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.

4.9 A "provision" is a liability of uncertain timing or amount.

COMMENTARY

4.10 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.

STANDARD

4.11 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.

COMMENTARY

4.12 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.

FINANCIAL REPORTING

5 RECOGNITION

Provisions

STANDARD

5.1 A provision must 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, a provision must not be recognised.

Present Obligation

STANDARD

5.2 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 balance date.

COMMENTARY

5.3 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 law suit, 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 balance date 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 balance date. On the basis of such evidence:

(a) where it is more likely than not that a present obligation exists at the balance date, 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 balance date, the entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 11.3).

Past Event

COMMENTARY

5.4 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.

5.5 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 balance date.

5.6 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.

5.7 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

balance date unless the decision has been communicated before the balance date to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities.

5.8 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.

5.9 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

COMMENTARY

5.10 For a liability to qualify for recognition there should not only be 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 11.3).

5.11 Where there are a number of similar obligations (for example, 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

COMMENTARY

5.12 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.

5.13 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 11.3).

Contingent Liabilities

STANDARD

5.14 An entity must not recognise a contingent liability.

COMMENTARY

5.15 A contingent liability is disclosed, as required by paragraph 11.3, unless the possibility of an outflow of resources embodying economic benefits is remote.

5.16 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.

5.17 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 a present obligation, previously dealt with as a contingent liability because it was not probable that an outflow of economic benefits would be required, is reassessed as requiring a probable outflow of future economic benefits, 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 — see paragraphs 5.12 and 5.13).

Contingent Assets

STANDARD

5.18 An entity must not recognise a contingent asset.

COMMENTARY

5.19 Contingent assets may 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.

5.20 A contingent asset is disclosed, as required by paragraph 11.6, except where an inflow of economic benefits is remote.

6 MEASUREMENT

Best Estimate

STANDARD

6.1 The amount recognised as a provision must be the best estimate of the expenditure required to settle the present obligation at the balance date.

COMMENTARY

6.2 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 balance date 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 balance date. 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 balance date.

6.3 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 balance date.

6.4 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 5.11, 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

6.5 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.

6.6 The provision is measured before tax, as the tax consequences of the provision, and changes in it, are dealt with under SSAP-12: *Accounting for Income Tax*.

Risks and Uncertainties

STANDARD

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

COMMENTARY

6.8 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 revenue 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.

6.9 Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph 11.2(b).

Present Value

STANDARD

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

COMMENTARY

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

STANDARD

6.12 The discount rate (or rates) must 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) must not reflect risks for which future cash flow estimates have been adjusted.

Future Events

STANDARD

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

COMMENTARY

6.14 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.

Expected Disposal of Assets

STANDARD

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

COMMENTARY

6.16 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 Financial Reporting Standard dealing with the assets concerned.

7 REIMBURSEMENTS

STANDARD

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

7.2 In the statement of financial performance, the expense relating to a provision must be presented separately from the revenue recognised for a reimbursement.

COMMENTARY

7.3 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.

7.4 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 probable that reimbursement will be received if the entity settles the liability.

7.5 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.

7.6 As noted in paragraph 5.16, 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.

8 CHANGES IN PROVISIONS

STANDARD

8.1 Provisions must be reviewed at each balance date 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 must be reversed.

COMMENTARY

8.2 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 an interest expense.

9 USE OF PROVISIONS

STANDARD

9.1 A provision must be used only for expenditures for which the provision was originally recognised.

COMMENTARY

9.2 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.

10 APPLICATION OF THE RECOGNITION AND MEASUREMENT RULES

Future Operating Losses

STANDARD

10.1 Provisions must not be recognised for future operating losses.

COMMENTARY
10.2 Future operating losses do not meet the definition of a liability in the *Statement of Concepts for General Purpose Financial Reporting* and the general recognition criteria set out for provisions in paragraph 5.1.

10.3 An expectation of future operating losses is an indication that certain assets of the operation may be impaired.

Onerous Contracts

STANDARD
10.4 If an entity has a contract that is onerous, the present obligation under the contract must be recognised and measured as a provision.

COMMENTARY
10.5 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.

10.6 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 net cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.

10.7 Before a separate provision for an onerous contract is established, an enterprise recognises any impairment loss that has occurred on assets dedicated to that contract.

Restructuring

COMMENTARY
10.8 A provision for restructuring costs is recognised only when the general recognition criteria for provisions set out in paragraph 5.1 are met. Paragraphs 10.9-10.20 set out how the general recognition criteria apply to restructurings.

STANDARD
10.9 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.

COMMENTARY

10.10 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.

10.11 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.

10.12 A management or board decision to restructure taken before the balance date does not give rise to a constructive obligation at the balance date unless the entity has, before the balance date:

(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.

In some cases, an entity starts to implement a restructuring plan, or announces its main features to those affected, only after the balance date. Disclosure may be required under the Financial Reporting Standard covering events after balance date, if the restructuring is of such importance that its non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions.

10.13 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 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 10.9 are met.

10.14 In some countries, the ultimate authority is vested in a board whose membership includes representatives of interests other than those of management (for example, 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.

STANDARD

10.15 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.

COMMENTARY

10.16 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 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.

STANDARD

10.17 A restructuring provision must 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.

COMMENTARY

10.18 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 balance date. Such expenditures are recognised on the same basis as if they arose independently of a restructuring.

10.19 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 4.8.

10.20 As required by paragraph 6.15, 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.

11 DISCLOSURES

STANDARD

11.1 For each class of provision, an entity must 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.**

11.2 An entity must 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 must disclose the major assumptions made concerning future events, as addressed in paragraph 6.13; and

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

11.3 Unless the possibility of any outflow in settlement is remote, an entity must disclose for each class of contingent liability at the balance date, a brief description of the nature of the contingent liability and, where practicable:

(a) an estimate of its financial effect;

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

(c) the possibility of any reimbursement.

COMMENTARY

11.4 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 11.2(a) and (b) and 11.3(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.

11.5 Where a provision and a contingent liability arise from the same set of circumstances, an entity makes the disclosures required by paragraphs 11.1-11.3 in a way that shows the link between the provision and the contingent liability.

STANDARD

11.6 Unless the possibility of any inflow of economic benefits is remote, an entity must disclose for each class of contingent asset at the balance date, a brief description of the nature of the contingent asset and, where practicable:

(a) an estimate of its financial effect;

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

(c) the possibility of any repayment.

COMMENTARY

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

STANDARD

11.8 When an estimate of the financial effect of a contingent asset is disclosed, the estimate must be accompanied by a description of the basis on which it has been prepared and whether the estimate has been prepared by an independent and qualified valuer.

11.9 The disclosures set out in paragraph 11.6 are not required for the following types of contingent assets:

(a) internally generated goodwill; and

(b) identifiable intangible assets.

11.10 Where the possibility of any outflow in settlement, or inflow of economic benefits, is remote, disclosure of a contingent liability or a contingent asset must be made, where practicable, if knowledge of the transaction or event is necessary to achieve the objectives of general purpose financial reporting.

COMMENTARY

11.11 Disclosure may be appropriate where the possibility of any outflow in settlement or inflow of economic benefits is remote but the potential impact of the item on the financial statement is high. For example, an entity may write a

guarantee for a customer covering a specific exposure. Where the probability of an outflow in settlement arising from the exposure is remote, but the amount that would be required to settle the obligation would place the entity at serious risk, the entity should disclose the contingent liability even though it is remote.

STANDARD

11.12 Where any of the information required by paragraphs 11.3, 11.6, and 11.10 is not disclosed because it is not practicable to do so, that fact must be stated.

11.13 In extremely rare cases, disclosure of some or all of the information required by paragraphs 11.1-11.3, 11.6, 11.8 and 11.10 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 must disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

12 TRANSITIONAL PROVISIONS

STANDARD

12.1 When an entity changes an accounting policy in order to comply for the first time with a requirement of this Standard, any revenue or expense must be recognised in the statement of movements in equity as an adjustment against equity at the beginning of the period in which the change is made.

12.2 Comparative information is not required to be presented in the first period of application of this Standard with regard to items required under this Standard that have not been disclosed in the entity's financial statements of the prior period.

APPENDIX 1

Comparison of FRS-15 with International and Australian Accounting Standards

This comparison appendix was prepared as at 31 May 2000 and deals only with significant differences in the standards. This appendix is produced for information purposes only and does not form part of the standards in FRS-15. The International Accounting Standards referred to in this appendix are promulgated by the International Accounting Standards Committee.

There is no corresponding Australian accounting standard on provisions and contingencies.

The International accounting standard comparable with FRS-15 is IAS 37 (1997): *Provisions, Contingent Liabilities and Contingent Assets*. There is substantial agreement between IAS 37 and FRS-15. The following summarises the significant differences.

Scope

FRS-15 excludes obligations of the Crown expressed in legislation that have characteristics similar to an executory contract; there is no such exclusion from IAS 37, although IAS 37 does not apply to non-business public sector entities.

Definition of contingent assets

IAS 37 defines a contingent asset as 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 enterprise. FRS-15 contains a wider definition of a contingent asset. FRS-15 defines a contingent asset as:

(a) 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; or

(b) an asset that is not recognised because:
   - (i) it is not probable that the economic benefits embodied in the asset will eventuate; or
   - (ii) the asset possesses a cost or other value that cannot be measured reliably.

Guidance on the recognition of assets

IAS 37 includes commentary on the recognition of assets arising from contingent assets. FRS-15 does not contain such commentary.

Treatment of reimbursements

FRS-15 requires that expected reimbursements of costs related to provisions are recognised when it is *probable* that they will be received if the obligation is settled. IAS 37 requires that expected reimbursements be recognised when it is *virtually certain* that they will be received if the obligation is settled.

FRS-15 requires that in the statement of financial performance the expense relating to a provision be presented separately from the revenue recognised for a reimbursement. IAS 37 allows in the statement of financial performance the expense relating to a provision to be presented net of the amount recognised for a reimbursement.

Disclosure of contingent assets

IAS 37 requires disclosure of contingent assets where an inflow of economic benefits is probable. FRS-15 requires disclosure of contingent asset except where an inflow of economic benefits is remote.

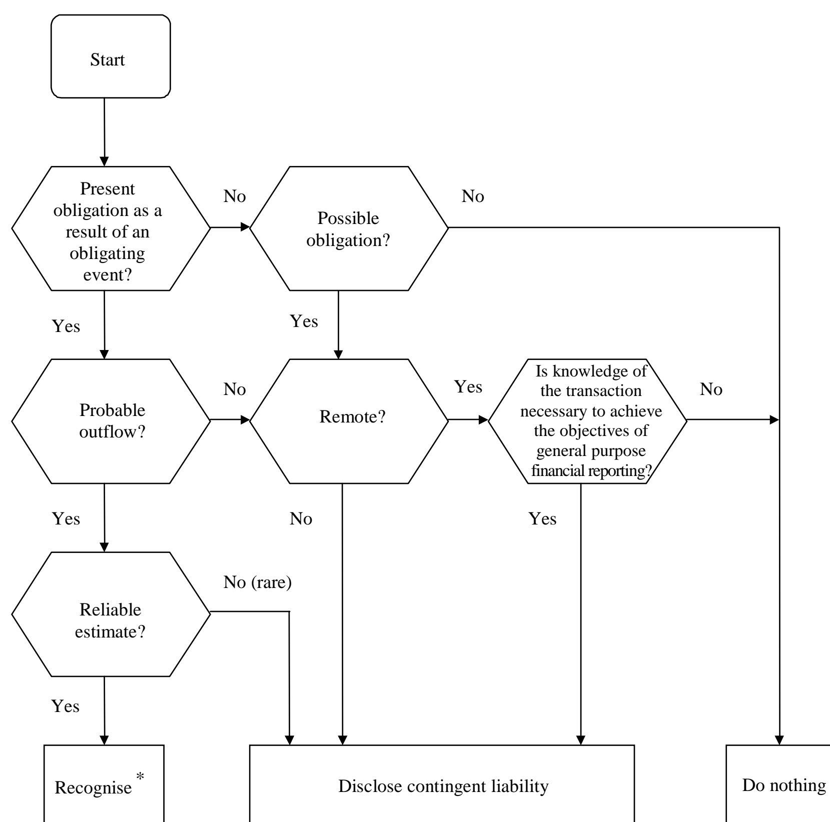
Remote cut-off

FRS-15 contains an additional disclosure requirement to the effect that consideration should also be given to the disclosure of contingent assets and contingent liabilities that are remote if knowledge of the transaction or event is necessary to achieve the objectives of general purpose financial reporting. IAS 37 contains no such requirement.

APPENDIX 2

Decision Trees

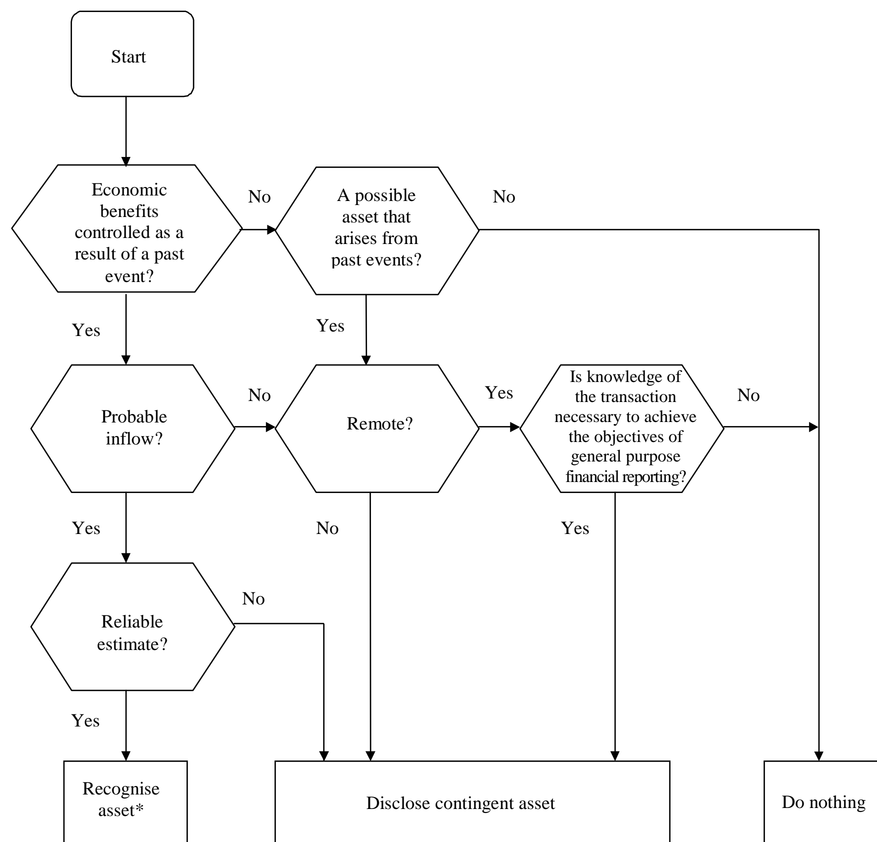
The purpose of the decision tree below is to summarise the main requirements of the standards for provisions and contingent liabilities. The decision tree does not form part of the standards and should be read in the context of the full text of the standards.



* Recognise a provision or "other recognised liability".

Note: 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 balance date (paragraph 5.2 of the Standard).

The purpose of the decision tree below is to summarise the main requirements of the standards for contingent assets. It does not form part of the standards and should be read in the context of the full text of the standards.



* This Standard does not deal with the recognition of an asset in these circumstances, as assets other than contingent assets are outside the scope of this Standard.

APPENDIX 3

Examples: Recognition

This appendix illustrates the application of the standards to assist in clarifying their meaning. It does not form part of the standards.

All the entities in the examples have 31 December year ends, unless otherwise stated. In all cases, it is assumed that a reliable estimate can be made of any outflows expected. In some examples the circumstances described may have resulted in impairment of the assets — this aspect is not dealt with in the examples.

The cross references provided in the examples indicate paragraphs of the Standard that are particularly relevant. The appendix should be read in the context of the full text of the standards.

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

Example 1: Warranties
A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On past experience, it is probable (i.e. more likely than not) that there will be some claims under the warranties.

Present obligation as a result of a past obligating event — The obligating event is the sale of the product with a warranty, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement — Probable for the warranties as a whole (see paragraph 5.11).

Conclusion — A provision is recognised for the best estimate of the costs of making good under the warranty products sold before the balance date (see paragraphs 5.1 and 5.11).

Example 2A: Contaminated Land – Legislation Virtually Certain to be Enacted
An entity in the oil industry causes contamination but cleans up only when required to do so under the laws of the particular country in which it operates. One country in which it operates has had no legislation requiring cleaning up, and the entity has been contaminating land in that country for several years. At 31 December 2000 it is virtually certain that a draft law requiring a clean-up of land already contaminated will be enacted shortly after the year end.

Present obligation as a result of a past obligating event — The obligating event is the contamination of the land because of the virtual certainty of legislation requiring cleaning up.

An outflow of resources embodying economic benefits in settlement — Probable.

Conclusion — A provision is recognised for the best estimate of the costs of the clean-up (see paragraphs 5.1 and 5.9).

Example 2B: Contaminated Land and Constructive Obligation
An entity in the oil industry causes contamination and operates in a country where there is no environmental legislation. However, the entity has a widely published environmental policy in which it undertakes to clean up all contamination that it causes. The entity has a record of honouring this published policy.

Present obligation as a result of a past obligating event — The obligating event is the contamination of the land, which gives rise to a constructive obligation because the conduct of the entity has created a valid expectation on the part of those affected by it that the entity will clean up contamination.

An outflow of resources embodying economic benefits in settlement — Probable.

Conclusion — A provision is recognised for the best estimate of the costs of clean-up (see paragraphs 4.1 (the definition of a constructive obligation), 5.1 and 5.4).

Example 3: Offshore Oilfield
An entity operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Ninety per cent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and ten per cent arise through the extraction of oil. At the balance date, the rig has been constructed but no oil has been extracted.

Present obligation as a result of a past obligating event — The construction of the oil rig creates a legal obligation under the terms of the licence to remove the rig and restore the seabed and is thus an obligating event. At the balance date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil.

An outflow of resources embodying economic benefits in settlement — Probable.

Conclusion — A provision is recognised for the best estimate of ninety per cent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it (see paragraph 5.1). These costs are included as part of the cost of the oil rig. The ten per cent of costs that arise through the extraction of oil are recognised as a liability when the oil is extracted.

Example 4: Refunds Policy
A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.

Present obligation as a result of a past obligating event — The obligating event is the sale of the product, which gives rise to a constructive obligation because the conduct of the store has created a valid expectation on the part of its customers that the store will refund purchases.

An outflow of resources embodying economic benefits in settlement — Probable, a proportion of goods are returned for refund (see paragraph 5.11).

Conclusion — A provision is recognised for the best estimate of the costs of refunds (see paragraphs 4.1 (the definition of a constructive obligation), 5.1, 5.4 and 5.11).

Example 5A: Closure of a Division – No Implementation Before Balance Date
On 12 December 2000 the board of an entity decided to close down a division. Before the balance date (31 December 2000) the decision was not communicated to any of those affected and no other steps were taken to implement the decision.

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 paragraphs 5.1 and 10.9).

Example 5B: Closure of a Division – Communication/Implementation Before Balance Date
On 12 December 2000, the board of an entity decided to close down a division making a particular product. On 20 December 2000 a detailed plan for closing down the division was agreed by the board; letters were sent to customers warning them to seek an alternative source of supply and redundancy notices were sent to the staff of the division.

Present obligation as a result of a past obligating event — The obligating event is the communication of the decision to the customers and employees, which gives rise to a constructive obligation from that date, because it creates a valid expectation that the division will be closed.

An outflow of resources embodying economic benefits in settlement — Probable.

Conclusion — A provision is recognised at 31 December 2000 for the best estimate of the costs of closing the division (see paragraphs 5.1 and 10.9).

Example 6: Legal Requirement to Fit Smoke Filters
Under new legislation, an entity is required to fit smoke filters to its factories by 30 June 2000. The entity has not fitted the smoke filters.

(a) At the balance date of 31 December 1999

Present obligation as a result of a past obligating event — There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.

Conclusion — No provision is recognised for the cost of fitting the smoke filters (see paragraphs 5.1 and 5.4–5.6).

(b) At the balance date of 31 December 2000

Present obligation as a result of a past obligating event — There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).

An outflow of resources embodying economic benefits in settlement — Assessment of probability of incurring fines and penalties by non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.

Conclusion — No provision is recognised for the costs of fitting smoke filters. However, a provision is recognised for the best estimate of any fines and penalties that are more likely than not to be imposed (see paragraphs 5.1 and 5.4–5.6).

Example 7: Staff Retraining as a Result of Changes in the Income Tax System
The government introduces a number of changes to the income tax system. As a result of these changes, an entity in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with financial services regulation. At the balance date, no retraining of staff has taken place.

Present obligation as a result of a past obligating event — There is no obligation because no obligating event (retraining) has taken place.

Conclusion — No provision is recognised (see paragraphs 5.1 and 5.4–5.6).

Example 8: An Onerous Contract
An entity operates profitably from a factory that it has leased under an operating lease. During December 2000 the entity relocates its operations to a new factory. The lease on the old factory continues for the next four years, it cannot be cancelled and the factory cannot be re-let to another user.

Present obligation as a result of a past obligating event — The obligating event is the signing of the lease contract, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement — When the lease becomes onerous, an outflow of resources embodying economic benefits is probable. (Until the lease becomes onerous, the entity accounts for the lease under SSAP-18: *Accounting for Leases and Hire Purchase Contracts.*)

Conclusion — A provision is recognised for the best estimate of the unavoidable lease payments (see paragraphs 2.8(c), 5.1 and 10.4).

Example 9: A Single Guarantee
During 1999, Entity A gives a guarantee of certain borrowings of Entity B, whose financial condition at that time is sound. During 2000, the financial condition of Entity B deteriorates and at 30 June 2000 Entity B files for protection from its creditors.

(a) At 31 December 1999

Present obligation as a result of a past obligating event — The obligating event is the giving of the guarantee, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement — No outflow of benefits is probable at 31 December 1999.

Conclusion — No provision is recognised (see paragraphs 5.10 and 5.15). The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (see paragraph 11.3).

(b) At 31 December 2000

Present obligation as a result of a past obligating event — The obligating event is the giving of the guarantee, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement — At 31 December 2000, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

Conclusion — A provision is recognised for the best estimate of the obligation (see paragraphs 5.1 and 5.10).

Note: This example deals with a single guarantee. If an entity has a portfolio of similar guarantees, it will assess that portfolio as a whole in determining whether an outflow of resources embodying economic benefit is probable (see paragraph 5.11).

Example 10: A Court Case
After a wedding in 2000, ten people died, possibly as a result of food poisoning from products sold by the entity. Legal proceedings are started seeking damages from the

entity but it disputes liability. Up to the date of approval of the financial statements for the year to 31 December 2000, the entity's lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to 31 December 2001, its lawyers advise that, owing to developments in the case, it is probable that the entity will be found liable.

(a) At 31 December 2000

Present obligation as a result of a past obligating event — On the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.

Conclusion — No provision is recognised (see paragraphs 5.2–5.3). The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (paragraph 11.3).

(b) At 31 December 2001

Present obligation as a result of a past obligating event — On the basis of the evidence available, there is a present obligation.

An outflow of resources embodying economic benefits in settlement — Probable.

Conclusion — A provision is recognised for the best estimate of the amount to settle the obligation (paragraphs 5.1–5.3).

Example 11: Repairs and Maintenance

Some assets require, in addition to routine maintenance, substantial expenditure every few years for major refits or refurbishment and the replacement of major components. The Financial Reporting Standard covering accounting for property, plant and equipment, gives guidance on allocating expenditure on an asset to its component parts where these components have different useful lives or provide benefits in a different pattern.

Example 11A: Refurbishment Costs – No Legislative Requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. At the balance date, the lining has been in use for three years.

Present obligation as a result of a past obligating event — There is no present obligation.

Conclusion — No provision is recognised (see paragraphs 5.1 and 5.4–5.6).

The cost of replacing the lining is not recognised because, at the balance date, no obligation to replace the lining exists independently of the company's future actions — even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining. Instead of a provision being recognised, the depreciation of the lining takes account of its consumption, i.e. it is depreciated over five years. The re-lining costs then incurred are capitalised with the consumption of each new lining shown by depreciation over the subsequent five years.

Example 11B: Refurbishment Costs – Legislative Requirement
An airline is required by law to overhaul its aircraft once every three years.

Present obligation as a result of a past obligating event — There is no present obligation.

Conclusion — No provision is recognised (see paragraphs 5.1 and 5.4–5.6).

The costs of overhauling aircraft are not recognised as a provision for the same reasons as the cost of replacing the lining is not recognised as a provision in example 11A. Even a legal requirement to overhaul does not make the costs of overhaul a liability, because no obligation exists to overhaul the aircraft independently of the entity's future actions — the entity could avoid the future expenditure by its future actions, for example by selling the aircraft. Instead of a provision being recognised, the depreciation of the aircraft takes account of the future incidence of maintenance costs, i.e. an amount equivalent to the expected maintenance costs is depreciated over three years.

Example 12: 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.

Public Sector Entity XYZ has a 30 June balance date. 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 5.1).

Example 13: 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 balance date (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 5.1 and 5.4–5.6).

(b) Applicant notified after the balance date

On 15 June 2000, Department M received an application for a Type B grant. After the balance date (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 5.1).

APPENDIX 4

Examples: Disclosure

The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.

Two examples of the disclosures required by paragraph 11.2 are provided below.

Example 1: Warranties

A manufacturer gives warranties at the time of sale to purchasers of its three product lines. Under the terms of the warranty, the manufacturer undertakes to repair or replace items that fail to perform satisfactorily for two years from the date of sale. At the balance date, a provision of $60,000 has been recognised. The provision has not been discounted as the effect of discounting is not material. The following information is disclosed:

A provision of $60,000 has been recognised for expected warranty claims on products sold during the last three financial years. It is expected that the majority of this expenditure will be incurred in the next financial year, and all will be incurred within two years of the balance date.

Example 2: Decommissioning Costs

In 2000, an entity involved in nuclear activities recognises a provision for decommissioning costs of $300 million. The provision is estimated using the assumption that decommissioning will take place in 60–70 years' time. However, there is a possibility that it will not take place until 100–110 years' time, in which case the present value of the costs will be significantly reduced. The following information is disclosed:

A provision of $300 million has been recognised for decommissioning costs. These costs are expected to be incurred between 2060 and 2070; however, there is a possibility that decommissioning will not take place until 2100–2110. If the costs were measured based upon the expectation that they would not be incurred until 2100–2110 the provision would be reduced to $136 million. The provision has been estimated using existing technology, at current prices, and discounted using a real discount rate of 2 per cent.

An example is given below of the disclosures required by paragraph 11.13 where some of the information required is not given because it can be expected to prejudice seriously the position of the entity.

Example 3: Disclosure Exemption

An entity is involved in a dispute with a competitor, who is alleging that the entity has infringed patents and is seeking damages of $100 million. The entity recognises a provision for its best estimate of the obligation, but discloses none of the information required by paragraphs 11.1 and 11.2 of the Standard. The following information is disclosed:

Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of 100 million. The information usually required by FRS-15: Provisions, Contingent Liabilities and Contingent Assets, is not disclosed on the grounds that it can be expected to prejudice seriously the outcome of the litigation. The directors are of the opinion that the claim can be successfully resisted by the company.

History

Previously issued accounting standards superseded by this Financial Reporting Standard:

SSAP-15: Accounting for Contingencies (issued December 1982 and effective for periods commencing on or after 1 April 1983).

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